



Milk Producers Council

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DATE: April 19, 2013
TO: Directors & Members

PAGES: 8
FROM: Rob Vandenheuvel, General Manager

MPC FRIDAY MARKET UPDATE

CHICAGO CHEDDAR CHEESE

Blocks - \$.0200 \$1.8600
Barrels - \$.0850 \$1.68500

Weekly Average, Cheddar Cheese

Blocks - \$.0120 \$1.8660
Barrels - \$.0385 \$1.7245

CHICAGO AA BUTTER

Weekly Change - \$.0975 \$1.6900
Weekly Average - \$.0620 \$1.7150

DRY WHEY

Dairy Market News w/e 04/26/13 \$.5650
National Plants w/e 04/20/13 \$.5766

NON-FAT DRY MILK

Week Ending 4/19 & 4/20

Calif. Plants \$1.4975 12,836,174
Nat'l Plants \$1.5480 23,123,955

Prior Week Ending 4/12 & 4/13

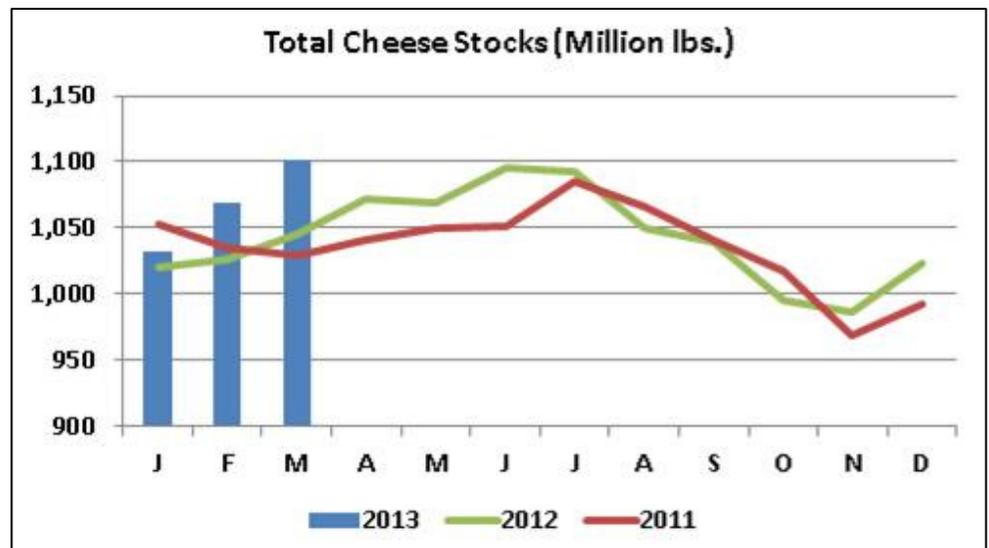
Calif. Plants \$1.4763 18,699,013
Nat'l Plants \$1.5113 32,218,357

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

Milk & Dairy Markets

Class III futures were mixed this week, with April through June and October through December contracts losing ground, while summer prices moved higher. Class IV contracts ended mostly lower. Dairy product prices at the CME spot market moved lower. Butter lost 9.75¢/lb., settling at \$1.69/lb. Cheddar blocks fell 2¢ to \$1.86. Barrels lost 8.5¢, closing the week at \$1.685. Grade A nonfat dry milk (NDM) ended at \$1.76, down 2.5¢. Extra Grade NDM held steady at \$1.70.

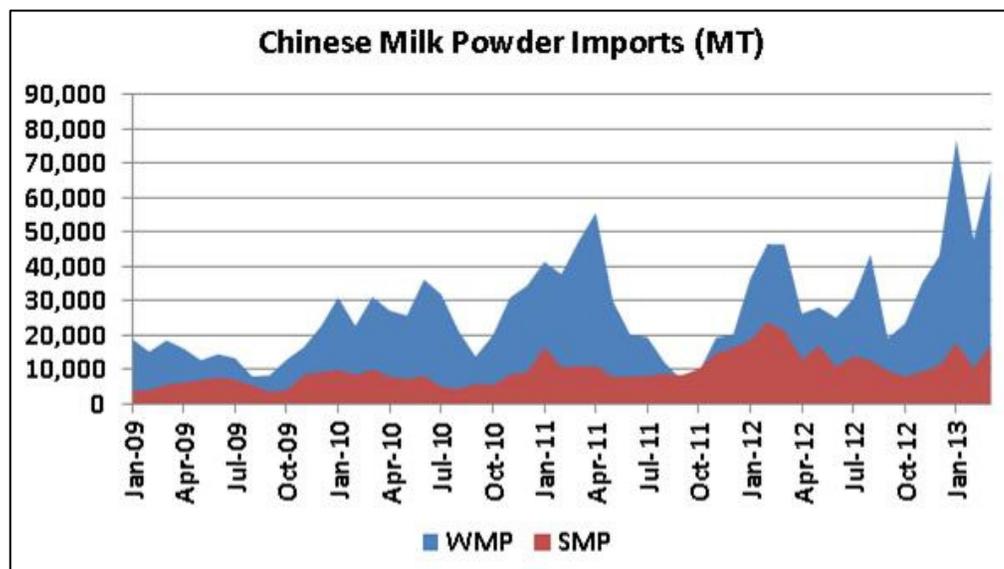
USDA's Cold Storage report showed that dairy products continued to move into storage in March, augmenting already heavy stock levels. Cheese stocks of all varieties totaled 1.1 billion lbs., a record for the month. This is 3.1% higher than February and 5.4% higher than March 2012. Butter stocks totaled 254.8 million lbs., up 6.9% from February and up 22.4% from the prior year. Butter stocks were also record large for this time of year. Cheese and butter inventories typically grow in



March due to the spring flush, but the size of the increases this year was larger than expected. The volume of U.S. dairy product inventories helps to explain the discount at the CME spot market relative to global prices. But with global dairy production waning, U.S. manufacturers have the potential to move product and use up stocks quickly.

Daily Dairy Report analysts estimate that Q1 milk production in the major exporting regions (Argentina, Australia, Europe, New Zealand and the United States) was 1.5 billion lbs. lower than the record levels set in 2012. Milk supplies typically grow by between 1.5% and 2% each year, keeping pace with global demand. According to Daily Dairy Report forecasts, Q2 2013 milk production could be nearly 1 billion lbs. lower than in Q2 2012.

Given this shortfall in global production, most dairy product prices outside the U.S. continue to move higher. The major exception is skim milk powder (SMP) in Oceania. After a dramatic run-up, SMP prices have retreated 6.07% in the past two weeks according to USDA's International Prices report. Whey prices in Western Europe also lost ground. All other dairy product prices moved higher in both Oceania and Western Europe. Notably, SMP prices increased by 5.9% in Western Europe, even as prices were falling in Oceania.



China continues to import huge volumes of dairy products, and there was no indication that New Zealand had any trouble supplying that demand last month. Indeed, Chinese imports of SMP from New Zealand in March increased by more than total month to month growth in Chinese SMP imports. China imported 16,914 metric tons (MT) of SMP in March, an increase of 47% from February but 20% less than in March 2012. Year to date SMP imports are 28% lower than a year ago.

Declines in Chinese SMP imports were more than offset by strong whole milk powder (WMP) imports. China imported 68,022 MT of WMP in March, up 29% from February and 47% more than March 2012. Year to date, China has imported 51% more WMP than in the first three months of 2012. The Chinese appetite for imported infant formula shows no signs of abating. Manufacturers have asked retailers to limit customers from purchasing large volumes of formula in stores as far away as the United Kingdom to prevent smugglers from bringing the product into China illegally. Since Hong Kong implemented restrictions on the amount of milk powder travelers can carry into China on March 1, customs officials have arrested more people for smuggling milk powder than all the heroin couriers detained by customs in 2012.

The California Weighted Average Price for NDM increased 2.12¢/lb. to \$1.4975. Sales volume was respectable at nearly 13 million lbs.

Weekly dairy cow slaughter was 63,922 head, up 7.9% from the same week a year ago. Year to date slaughter is 4.4% ahead of last year's pace. Dairy cow slaughter in the first quarter of the year was the largest in the past decade, although March dairy cow slaughter was actually slightly lower than a year ago.

Grain and Hay Markets

After much delay, the sun is finally shining in the Corn Belt. This will likely boost beef and barrel Cheddar demand, as Midwesterners break out the grills and enjoy many long awaited cheeseburgers. This could help to narrow the unusually wide spread between Cheddar blocks and barrels.

The sunny weather is also good news for farmers, who have been kept out of fields by very heavy rains. Rainfall in Illinois has already exceeded the record for the month, with a few days to go. This has been among the wettest springs ever in much of the Corn Belt. The rains are helping to replenish soil moisture reserves in parts of the Western Corn Belt and Plains, which are still in drought. However, farmers are anxious to start planting, and without a block of clear days in the next few weeks, some farmers may shift acreage from corn to soybeans. New crop grain and oilseed markets will be volatile and highly dependent on the forecast.

Corn futures ended a little lower this week, and soybean meal prices moved higher. U.S. soybean and soybean meal exports have been unusually strong for this time of year due to continued logistical issues in Brazil and slow farmer selling in Argentina. The long term uptrend in Argentine soybean yields has stagnated as farmers there now plant soy year after year. Farmers are forgoing crop rotation because the government limits corn and wheat exports to assure low domestic prices for food grains. Thus, farmers prefer to plant soybeans so they can participate in much higher global prices.

But while U.S. soybean exports have been boosted by issues in South America, global soybean exports are suffering as Chinese demand continues to fall. Given lower feed needs as a result of the bird flu, China could delay some of their old crop soybean contracts to new crop. They have enough supplies on hand to satisfy current domestic needs.

U.S. hay exports to Japan could decline as the falling yen encourages producers there to feed as much domestically produced feed as possible. This could remove some competition for hay supplies in California.

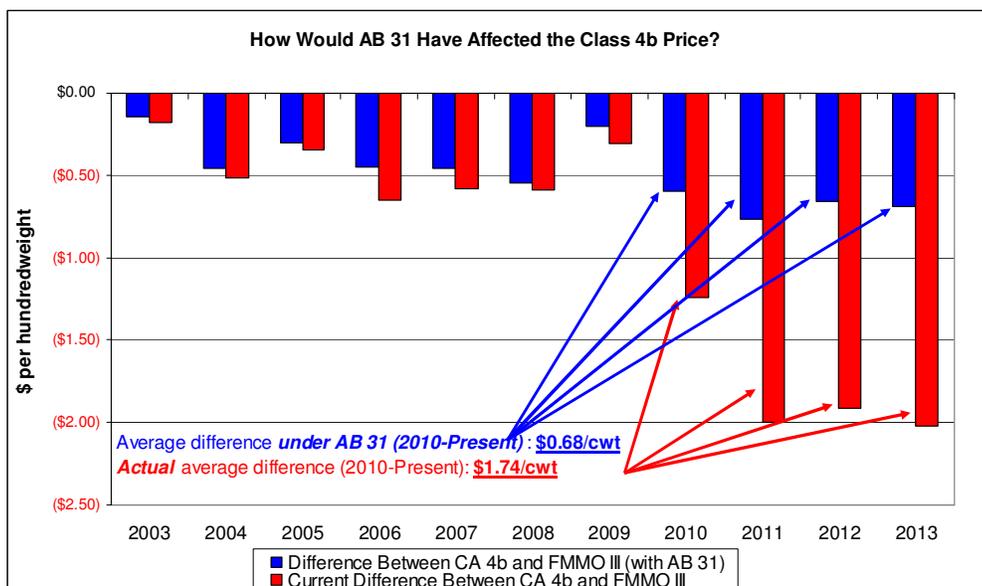
FRED DOUMA’S PRICE PROJECTIONS...

Apr '13 Final:	Quota cwt. \$19.00	Overbase cwt. \$17.30	Cls. 4a cwt. \$17.98	Cls. 4b cwt. \$16.92
Last Week:	Quota cwt. \$19.03	Overbase cwt. \$17.34	Cls. 4a cwt. \$18.05	Cls. 4b cwt. \$16.95

ASSEMBLY AG COMMITTEE HEARING ON AB 31 THIS COMING WEDNESDAY: (By Rob Vandenhuevel) Next Wednesday, May 1st, the California Assembly Ag Committee will be conducting their hearing on AB 31 (more info on AB 31 at: <http://goo.gl/UQP8z>). As we’ve discussed in the past couple months, this hearing is the first step in moving AB 31 through the full legislative process. As a reminder, AB 31 would result in the California Class 4b price (for milk sold to California’s cheese manufacturers) tracking in a closer relationship with the Federal Order Class III price (which is used as the benchmark price for comparable milk sold around the country).

The hearing is scheduled for 1:30 p.m. on Wednesday, May 1st in Room 126 of the State Capitol Building. **For those in the South Valley region interested in carpooling to the hearing, Western Milling is coordinating a bus, which will be leaving from the Visalia Holiday Inn (9000 W. Airport Drive) at 8 am on May 1st. Folks interested in taking advantage of this opportunity should call De Anna Fitzgerald at (559) 302-1078.**

It’s critically important that the Committee members understand the importance of providing California’s dairy farmers with a milk price that is comparable with prices paid for milk around the country. **We simply cannot afford to continue providing a state-sponsored \$800 million discount (since 2010) on the milk we sell to cheese manufacturers; it is destroying California’s dairy farming community.** The hearing on May 1st is an important step towards changing that.



IN CASE YOU MISSED IT...A HOARD'S DAIRYMAN Q&A WITH MPC VICE-CHAIRMAN GEOFFREY VANDEN HEUVEL:

Hoard's Dairyman, April 25, 2013

<http://www.hoards.com/13apr25-california-dairies-leaving>

California's pricing system is killing its dairies

Some are already gone. More will follow. The big question is, how many can be saved?

By Hoard's Dairyman Staff

The greatest milk-producing machine the U.S. dairy industry has ever seen is breaking down.

Doomsday feed prices and apocalyptic milk price volatility in 2009 exposed a fatal flaw in the "California style" business model of growing no feed. They also triggered a landslide of debt that buried many of the state's producers and turned survival into a daily struggle. It transformed their financing world as well.

Today, monthly profitability is more critical than most California producers could have ever imagined. Every penny per hundredweight and per ton matters. And yet, the state's complex milk pricing system that fueled meteoric growth for 40 years not only isn't helping producers, but some say it is killing them.

The gist of their belief is that the Department of Food and Agriculture has historically interpreted the pricing system as a way to encourage processors to make plant capacity available for every pound of milk that is produced. In the wake of the industry's 2009 meltdown, however, producers have become increasingly more vocal that the department is ignoring at least two directives in the state's Food and Agriculture Code that are aimed at promoting their existence:

- ***Section 61805(d) – "Enable the dairy industry, with the aid of the state, to develop and maintain satisfactory marketing conditions, bring about and maintain a reasonable amount of stability and prosperity in the production of market milk..."***
- ***Section 62062 – "...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."***

Producer groups have been at odds with processors and the department for years over the "begging with hat in hand" nature of the hearing process to seek price relief, and disgusted with outcomes that have sometimes been small but have more often been nothing. In recent years as economic conditions have reached fatal proportions, unhappiness has escalated into full-blown rebellion.

Multiple meetings have been held to discuss replacing the state pricing system with a Federal Milk Marketing Order (FMMO), and a lawsuit was even filed against the department in 2012 for failing to keep California's Class 4b (cheese) milk prices in "reasonable alignment" with FMMO Class III prices. The difference averaged \$2 per hundredweight during 2011 and 2012.

One of the loudest voices for California milk producers belongs to Geoffrey Vanden Heuvel. The operator of a 1,250-cow dairy in Chino, Vanden Heuvel has been active in California dairy policy making for 28 years. He has testified at nearly every California milk price hearing since 1985 and has occasionally participated in USDA and Congressional Farm Bill hearings in Washington, D.C. He is candid, direct and extremely well informed. He is also fiercely passionate about the dairy industry, which means he not only has a lot to say about the current state of California dairying, but he is not shy about doing so.

QUESTIONS & ANSWERS

Dennis Halliday, Hoard's Dairyman: Has the relationship between California dairy farmers and the Department of Food and Agriculture changed in recent years?

Geoffrey Vanden Heuvel, Dairyman: “I don’t think there’s been a change in the department; I think there’s been a change in the economic realities. In order to understand why, you need to get some historical context.

“If you go back to 1977, California was just over half the size of Wisconsin in milk production and the dairy industry convinced Congress to pass a farm bill that supported milk at 80 percent of parity with semi-annual price adjustments. The practical implications were that over a four-year period the support price went from \$8.26 per hundredweight to \$13.49. What did California dairies do with the money? We invested in more cows and more processing plants.

“Because we had a state order we could use it to essentially confiscate part of the money that was intended to go to dairy farmers and give it to processors as an incentive to build more plants to accommodate the milk that those additional cows were going to make. The bottom line is that with cheap feed we were able to build our industry and we caught Wisconsin within a decade.

“[In my opinion] it was as a result of that tremendous growth that the department developed the mind-set it still has today which is the problem: that plant capacity is the most important single factor and indicator of what the milk prices it establishes must be.

“Despite the fact that the law that gives the department the responsibility and authority to set milk prices also tells it that it has to consider producer profitability, what milk is selling for in other parts of the country, and the “reasonable relationship” language that is in the law. What you hear time and time again in the questions that department economists ask at hearings is, its concern is the viability of plants. Its equation essentially is that there are 1,700 dairies and 60 plants. If we lose a bunch of dairymen it bothers them, but not near as much as losing one or two plants. The department has a belief that plants must buy milk cheap in order to survive.”

Halliday: In testimony at the state’s most recent milk price hearing on December 21 your son Rob, manager of Milk Producers Council in Southern California, said, “It is abundantly clear that the needs of manufacturers have been a priority of the California Department of Food and Agriculture over the years.”

Vanden Heuvel: “And I don’t think the department would argue with that. In all of its findings it is clear that it is most concerned about putting no stress on the processing sector whatsoever. What’s strange to me is, the practical impact of the department’s decisions is the demise of the productive capacity of milk producers of California.

“I think what the problem comes down to is, the department has become accustomed to doing things the way it has for a long time. It is setting minimum prices only, those prices have to be market clearing prices, and they can not raise those prices if there is any chance they’ll end up with inadequate plant capacity. It is taking it as their obligation to see that there is a California home for any gallon of milk that any California dairyman wants



“What is happening in the California dairy industry right now reminds me of when I went to Niagara Falls. About a mile upstream is a sign that says, “Point of no return.” It means if you are in the water at that point they can’t save you. I think that is where about 25 percent of our dairies are now – they are still in business, but they are going to go over the falls and they can’t be saved.” – Geoffrey Vanden Heuvel

to produce. That’s the policy it has been implementing for the last 40 years.

“But one of the questions you have to ask is, where in the law is the foundation for that policy? Secondly, and as

a practical matter, if California dairymen produce too much milk, who bears the cost of disposal? It's not the plants; they buy what they want. It's the dairy farmers. The department is basically saying, "We have to kill you to save you. We have to keep milk cheap so there will always be a plant to buy your milk."

"The perversion of this is that the department has made it so easy for California plants by discounting milk, we have ended up with very lazy plants. They have no incentive to move up the value chain, and why should they? Almost all of the risk has been taken out for the plants."

Halliday: **Is the California dairy industry at a crossroads today, or is it an intersection where a wreck is occurring?**

Vanden Heuvel: "Probably both. We're already well on the path to whatever we're going to be. The California dairy industry is absolutely in a transition and there are casualties every day.

"This problem will get fixed. There is no doubt in my mind that there will come a day when California milk processors will be paying a competitive price for milk. The question is, how many casualties will happen and how much damage will be done between now and then? When they write the history of this period in California, the big question that people may not be able to answer is, why did the state, which had all this ability and authority to use the tools of government and all the reasons to use them, behave and make the decisions it made? Why did it ignore the producers?"

"Indications are that the department still doesn't believe us. In its defense, I've got to say that I've been raising issues about the viability of our model for years – and yet production continued to go up. I think it's a case where the department isn't convinced yet that it is doing damage.

Destroying productive capacity

"But the effect of its policy is to destroy the productive capacity of the dairy industry. There is really no arguing that. I think the game changing difference is the banking industry, which made tons of money on the California dairy industry as it expanded all over the country, has begun to look at the dairy industry much differently. Clearly, without access to capital we never could have built what we built, and that access to capital is pretty much being cut off today.

"As long as producers have breath and energy in their bodies there will be no peace in the California dairy industry until this issue gets resolved. Unfortunately, we are stuck right now where we have the worst of both worlds. We have producers who are not getting adequate income to pay their bills, and processors who are benefitting from that but are unwilling to risk hundreds of millions of dollars on investment [in new plant capacity] because they intuitively know it can't last. We're buying absolutely nothing for our cheap milk right now except misery.

"If I could sum up the department's policies during the last 12 months it would be, it's just stupid. Why would a body whose responsibility is to carry out a law [Section 61805(d) of the Agricultural Code] do what it is doing? If that's what the state Legislature told you to do as an administering body, and you look at the results of its decisions, how can you describe those decisions as anything other than stupid? At some point the department will "get it" or the market will take over.

"Every day that passes as this pressure comes to bear, there is less and less time to fix the problem. We just don't know how much we have left. As dairy farmers our backs are to the wall. This is survival. When your livelihood is on the line and you're fighting for your home, it clarifies the mind and energizes you.

"There are some potential remedies we have by going back to the California State Legislature, and Western United Dairyman has already introduced such a bill. The state Legislature is going to hear a lot about the plight of dairy farmers in the next six months; this will get attention."

Halliday: Near the end of your testimony in the December 21 hearing you told the department panel, “We need a little hope, and I guess the question for the department is are you going to give us some?” Is hope enough or is it just a Band-Aid?

Vanden Heuvel: “It’s not enough to solve the problem, but if people have just a little hope they’ll fight. They’ll fight to hang on and stay alive because of the hope that there might be a rescue. But if there’s no hope they’ll quit. I said earlier that change is coming for the California dairy industry; that’s inevitable. The question is, how much of this industry can we save? Hope is a huge factor in the answer. If there’s some hope, producers will put in extra effort to stay alive.

“The other side of the question about how much of the industry can be saved is, how much of the industry that’s still here are we going to lose no matter what happens? The reality is there are a lot of people who are milking cows today that won’t be here much longer because the financial momentum underway in the industry has taken them past the point of being saved.

“I don’t think the department is paying very close attention to that. I think it looks at the supply of milk and sees that we’re down a little, but it thinks we might bounce back and go way up. So it thinks, “we need to be very careful about giving dairy farmers too much money because if we do they’ll produce too much milk and we won’t have a place for it.”

“I would ask since when, and where is the authority in the law, that makes that the overriding consideration for every policy decision it makes? The only thing the department can show is some bland language that talks about stability, and it has taken that one little phrase and created a policy that drives everything it does. Its definition of stability has become “a California home for any gallon of milk that a dairyman wants to produce.”

“Therein lies the problem. The law doesn’t say that, but it has become the department’s policy. This doesn’t make the department evil; it makes it wrong. It is misunderstanding and misinterpreting what its job is. But you have to walk in the department’s shoes; from its perspective it thinks that is its job. And that’s been its perspective for 40 years, because that’s what its people have inherited from their predecessors.”

Halliday: Pretend that California dairy farmers suddenly got a level milk price playing field with producers in the rest of the country. If that happened, would California processors close up shop and leave?

Vanden Heuvel: “Of course not. That’s the most ludicrous thing. Do you think a company with a billion-dollar investment is going to pack up? Where would it go? The crazy thing is, department officials continue to buy that line. Processors aren’t going to go anywhere; we’re all on this ship together.

“In my testimony I told the department, ‘What is the market that your policy decisions created telling me? It’s basically telling me I need to get out of business. Intellectually I’m okay with that. But is it really fair to tell California dairy farmers they ought to get out of business when the state is deliberately discounting their milk?’”

Has the current intensity of the disagreement between producers and the department, culminating with the lawsuit against the department claiming it has failed to follow the Agricultural Act, burned any bridges?



“This problem will get fixed. There is no doubt in my mind that there will come a day when California milk processors will be paying a competitive price for milk. The question is, how many casualties will happen and how much damage will be done between now and then?”

– Geoffrey Vanden Heuvel

“Even though we’re all human beings and we all have emotions, I would hope that we are all professionals and

we can all put our emotions in check. We ought to be able to speak truth to power; we ought to be able to call it as we see it. And I think that's all we're doing. We think the department is wrong and the court system exists to resolve these types of disputes. We went to the court and we got an answer we didn't like or agree with; we found out there is no remedy there.

Now looking at a federal order

“There are two other ways to get change. One is to go to the legislature and get a more clear, succinct law that will change the way the department applies the law, and we're pursuing that. The other is to change the administrator by looking at a federal marketing order.

“The process of making a change is much more of a marathon than a sprint. There will be some dairies left when it is over; the question is how much damage will be done. The quicker we can turn this thing around and change, the more of this industry we can preserve and the better off it will be in the future. The pain and anguish and loss that have already occurred are enormous. The toll it continues to take financially and emotionally on the producer sector is enormous. The sad part is it doesn't have to be this way. It just doesn't. I've never seen a situation where a state's Department of Agriculture is at war with its own farmers, but ours is.

“There's always been a belief that if all producers could get on the same page then we would get what we need. But we demonstrated that is not true. We had 100 percent producer unanimity in the December 21 hearing. We were all together. It wasn't for lack of resources and it wasn't for lack of unity, but we still got nothing.

“California dairy farmers have had a heck of a run. They really have. The California dairy industry has been a phenomenal success story. It was built on cheap feed, but I don't think feed is ever going to be cheap again. Therefore, the model that built it is forever gone. So it has to adjust and adapt, it will adjust and adapt. The question is, how long will it take and who gets to be part of what is left?

“You've always had a certain amount of natural selection go on among producers. That's normal, but the department is going to kill off more of the human and material capital than it needs to because of the stupidity of its policies. But at some point there will be a change in policy. Of that I have no doubt.”