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: May 15, 2015 **PAGES: 5**
TO: Directors & Members **FROM: Rob Vandenheuvel, General Manager**

MPC FRIDAY MARKET UPDATE

CHICAGO CHEDDAR CHEESE		
Blocks	*+$.0075*	$1.6200
Barrels	*+$.0025*	$1.6225
Weekly Average, Cheddar Cheese		
Blocks	*+$.0050*	$1.6155
Barrels	*- $.0040*	$1.6240

CHICAGO AA BUTTER		
Weekly Change	*- $.0125*	$1.9725
Weekly Average	*+$.1250*	$2.0160
DRY WHEY		
Dairy Market News	w/e 05/15/15	$.4300
National Plants	w/e 05/08/15	$.4335

NON-FAT DRY MILK		
Week Ending 5/8 & 5/9		
Calif. Plants	$0.9277	14,076,508
Nat'l Plants	$0.9414	18,542,278
Prior Week Ending 5/1 & 5/2		
Calif. Plants	*$0.9557*	*14,988,436*
Nat'l Plants	*$0.9506*	*19,773,154*

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FRED DOUMA'S PRICE PROJECTIONS…

May 15 Est:	**Quota cwt. $15.86**	**Overbase cwt. $14.17**	**Cls. 4a cwt. $13.88**	**Cls. 4b cwt. $14.59**
Last Week:	**Quota cwt. $15.85**	**Overbase cwt. $14.15**	**Cls. 4a cwt. $13.89**	**Cls. 4b cwt. $14.56**

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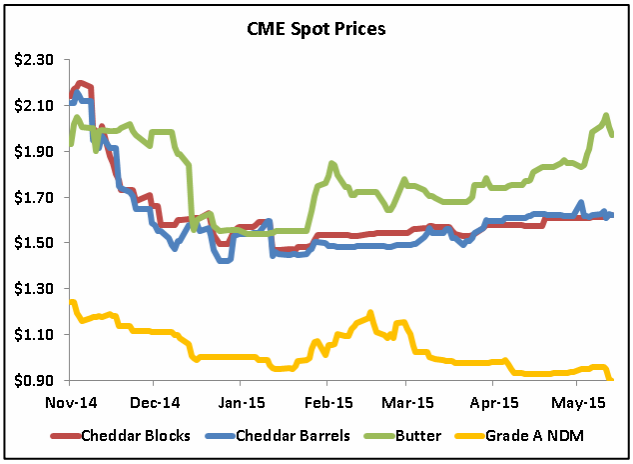
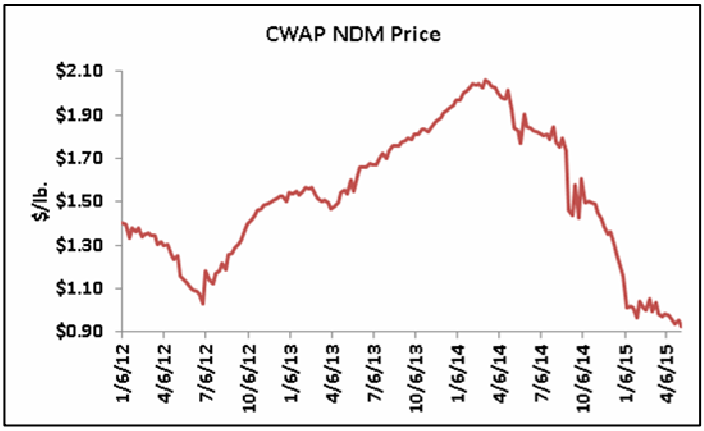
MARKET COMMENTARY: *(By Sarina Sharp, Daily Dairy Report, sarina@dailydairyreport.com)*



Milk & Dairy Markets

In just six sessions, CME spot butter climbed 22¢, reaching $2.06/lb. on Wednesday, its highest level in nearly seven months. But the butter market's dramatic stint above $2 was brief, evoking comparisons to Icarus flying too close to the sun or the hare petering out at the end of the race. Spot butter plunged Thursday and Friday and ended the week 1.25¢ lower than it began, at $1.9725. Butter futures dropped their daily limit on Thursday and lost as much as 8¢ Friday under expanded trading limits.

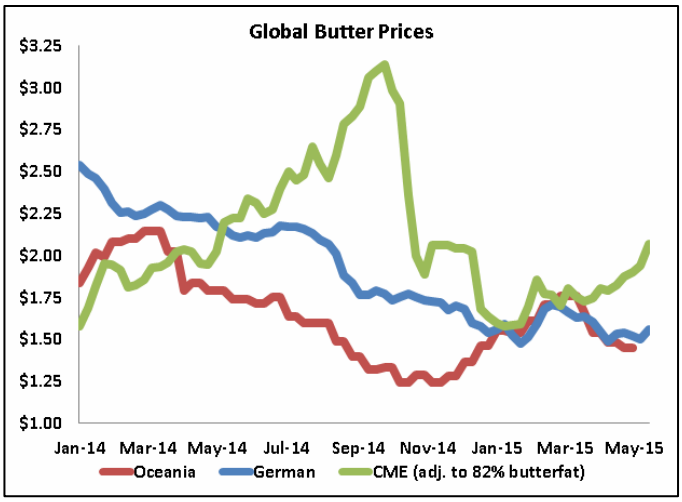
Spot nonfat dry milk (NDM) faded, falling 6¢ to $0.8975. Indications of the wholesale milk powder market also weakened. The California Weighted Average Price (CWAP) for NDM dropped to 92.77¢. Both the spot and CWAP NDM price have not been this low since August 2009. Dairy producers will be forgiven for cringing at the mention of that painful year, but they can be cheered with the reminder that cheese, butter and whey prices are markedly higher than they were in 2009, and feed is significantly cheaper.



If the spot butter market is the hare, then Cheddar is undoubtedly the tortoise. Spot Cheddar blocks climbed 0.75¢ on Thursday and then held at $1.62. Cheddar barrels moved back and forth but ultimately closed at $1.6225, up 0.25¢ on the week. Class III futures were unconvinced by the tepid strength in spot cheese. The

July contract lost a dollar this week and all 2015 contracts closed sharply lower than last Friday's spike. Nearby Class IV futures also weakened, but the November and later contracts managed to gain ground this week.

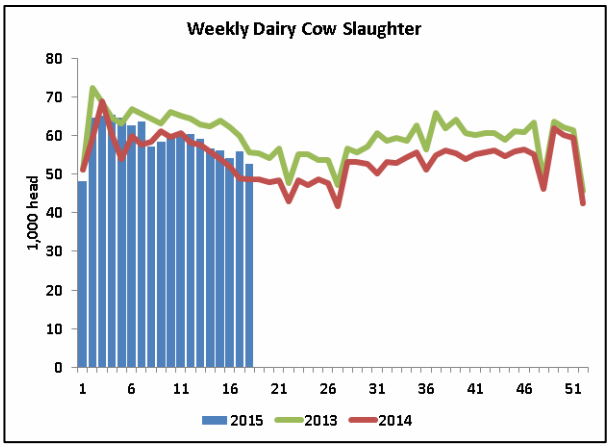
The spring flush is underway in the Midwest and Northeast, and by all accounts production is formidable. Fluid milk demand is waning seasonally, and cheese plants and driers are running hard. With milk powder below a dollar, cheese makers are likely buying powder to fortify their product and increase output. Domestic cheese demand is robust, but perhaps not strong enough to absorb the full brunt of rising production. Cheese makers are likely filling warehouses with product they hope to sell later in the year.



As USDA noted in its Cold Storage report last month, butter inventories at the end of March were 3.9% lower than they were in 2014, and the spot market was similarly buoyant at this time last spring. Butter stocks bucked seasonal trends and moved lower from March to April last year, launching the market to unprecedented heights. This time around, cheese output is reducing the amount of cream available to butter manufacturers, and ice cream makers are drawing heavily on cream supplies, so a similar scenario is not outside of the realm of possibility.

But this time feels different. With so much milk available, it seems strange that butter production could be low enough to justify a $2 price tag, when product in Europe and Oceania is closer to $1.50. *Dairy Market News* reports that "Current pricing levels have most manufacturers perplexed," and notes that while butter production is slowing in the West, it is fairly active in the Midwest and Northeast. According to Dairy Market News, "Most companies want to increase inventories… and some are able to."

Foreign dairy markets continue to slide. Over the past two weeks, butter prices have fallen 0.4% in Oceania and 1.5% in Western Europe. Milk powder prices also lost ground in both markets. But the impact of these losses has been dulled by currency relationships. Although far from weak by historical standards, the almighty dollar is not as strong as it once was. After reaching 12-year highs in March, the dollar now stands at its lowest level in four months against a basket of foreign currencies. The weakness is good news for U.S. dairy exports, which could use a little help maintaining their competitive edge while overseas markets slip.



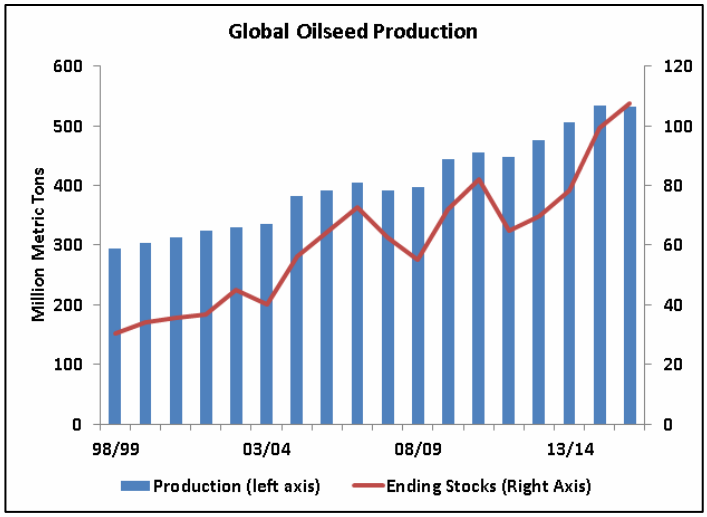
For the week ending May 2, dairy cow slaughter totaled 52,764 head, the lowest total for a non-holiday week since August. Still, this was 8.6% greater than the same week a year ago, bringing the year-to-date cull rate 3.9% ahead of the 2014 pace.

Grain Markets

On Tuesday, the USDA issued its first look at supply and demand for the 2015-16 crop year. The report held no surprises for the corn market. Although next year's crop is expected to be quite large, it is likely to fall short of last year's bin-buster. Corn futures gained a few cents this week, riding on the coattails of a much stronger wheat market. Investment funds held a large short position in the wheat market, but amidst a dearth of bearish news and concerns about rain damage in the Plains, they started buying it back this week. July wheat futures ended nearly 30¢ higher than last Friday.

According to USDA, farmers are likely to plant more soybeans and less corn this year, although soybean yields will have to be better than average to best last year's crop. Nonetheless, a decent U.S. crop and a spectacular season in South America is likely to result in another marked increase in global oilseed supplies. Although

USDA's assessment was not too far from analysts' expectations, the soybean market dropped after the report. November soybean futures settled at $9.345/bushel on Friday, down nearly 20¢ on the week.



U.S. corn and soybean acreage might be even higher than USDA estimates, as the pleasant spring may have reduced the amount of land fallowed for crop insurance. The trade will continue to debate the minutiae of the acreage mix, but the real focus from here forward will be the weather. It is foolhardy to make too many assumptions at this early stage, but here too, the news is not bullish. The National Weather Service's Climate Prediction Center says the current El Niño has a 90% chance of lasting through the summer, although they expressed "considerable uncertainty" about the strength of the event. Moderate and strong El Niños typically bring about cool, wet summers in the Midwest, often resulting in better than average corn yields.

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A CLOSER LOOK AT THE CA-FMMO PROPOSALS - QUOTA: *(By Rob Vandenheuvel)* Last week, USDA held their three "Outreach Meetings" in California, with meeting attendee's getting presentations from the proponents of the four specific proposals for establishing a Federal Milk Marketing Order (FMMO) in California. As a reminder, those four proposals are on behalf of:

1. The three major California cooperatives (California Dairies, Inc., Dairy Farmers of America and Land O'Lakes) *(with unified support from the boards of California Dairy Campaign, MPC and Western United Dairymen)*
2. The Dairy Institute of California (on behalf of the California milk processors they represent)
3. The California Producer Handler Association (on behalf of Foster Dairy Farms, Hollandia Dairy, Producers Dairy Foods and Rockview Dairies)
4. Ponderosa Dairy (a large dairy farm Amargosa Valley, Nevada)

It's worth noting that the first two proposals listed above are complete proposals, each outlining all the details they'd like to see in a California FMMO. The last two proposals listed above are focused on specific parts of the proposed California FMMO.

Over the coming months, we will publish a series of articles looking at how the various proposals compare on major issues. Most of that comparative analysis will be focused on the first two proposals, as they address all the major issues that would be considering in a California FMMO hearing. But as we get to issues relating to producer-handlers and out-of-state milk, we will obviously look at the last two proposals as well.

One important note before we get into our first comparison: Assuming that there is, in fact, a hearing held by USDA (we won't know for sure until they announce their decision sometime this summer), the final decision by USDA on the details of a California FMMO will be subject to a referendum vote of producers and their cooperatives. While the State's processors or other non-producer interested parties are all welcome to participate in the hearing, it is only the producers and their cooperatives that may vote in a referendum to accept or reject the final California FMMO. Keep that in mind as you process the details of the various proposals we will be discussing.

As we launch the first in this series of articles, we'll start with an issue near-and-dear to many California producers' hearts: **the California quota program**.

First, some background:

As most of our readers know very well, California has operated a "quota" program since the State adopted a pooling program in the 1960s. There is a long and storied history of the State's quota program – enough for an article of its own, for sure. But for the purposes of this article, we'll discuss the quota program as it exists today in 2015.

In short, any California producer who holds quota and sells milk to a pooled handler in any given month will receive additional revenue for that volume of milk. We will call that additional revenue the "quota premium". Quota premiums are based on pounds of solids-not-fat (SNF) produced. A single pound of quota SNF is eligible for a premium payment of $0.195 per day. For standard milk with 8.7% SNF, this comes out to $1.6965 per cwt (it's of course no coincidence that this is the gap between the announced overbase and quota prices per cwt each month). I should note that the $1.6965/cwt payment is reduced by a "Regional Quota Adjuster" of between $0.05 to $0.27 per cwt for a majority of the most producers in the state (again, another historical issue that could be its own article).

Quota can be bought and sold amongst the California producers. In fact, CDFA publishes a monthly report showing the transfers of quota (http://cdfa.ca.gov/dairy/mp_sum_transfers_toc.html). For instance, in April 2015, 913.76 pounds of quota SNF were transferred at an average price of $525 per pound.

More than 2.15 million pounds of quota SNF are currently owned by California producers. That figure has been constant for many years, as no new quota has been issued in more than two decades. So as I'm sure you've already done by now, the math on 2.15 million lbs of quota at $525 per pound gives you an asset value of more than $1.1 billion.

Using the 2.15 million pounds of quota SNF, you can also do the math on how much of the monthly "pool" needs to be used each month to pay the quota premium. In simple terms, the quota holders are entitled to the first ~$12 million per month from the pool *(2.15 million x $0.195 x number of days in the month, offset by the Regional Quota Adjuster)*. The remaining funds are then spread out amongst all the producers. So in essence, the milk covered by quota receives the overbase – or blend – price, plus the quota premium. Of course the math in real life gets more complicated, but these simple calculations work for our purposes.

As I said earlier, the issue of quota has a storied history, and there have been numerous discussions over the years about California's quota program, how it operates, and its future. Former CDFA Secretary AG Kawamura even set up a "Quota Review Committee" in 2007 to delve more deeply into these issues. However, none of these discussions have resulted in an alternative path forward acceptable to California producers, and therefore the quota program has continued on in its current form. **So what does all this mean in the context of a California FMMO proposal?**

PROPOSAL ONE – THE COOPERATIVES

From the first time the three California cooperatives mentioned they would be developing a California FMMO proposal, they made it clear that any acceptable proposal must include the ability to continue California's quota program. They even worked with MPC and the other California producer trade associations to secure language in the 2014 Farm Bill ensuring that USDA could consider a California FMMO that includes a quota program (Hanford Congressman David Valadao was our champion on getting that language included).

Therefore, as we now delve into the detailed California FMMO proposal put forth by the three cooperatives, we see that they have prominently included **provisions to maintain the California Quota Program almost exactly as it operates today** *(I say "almost" because while producers will see no changes in how their quota is treated, USDA would be playing a role that is currently played by CDFA).*

In short, the cooperatives have proposed that CDFA continue to oversee the details of the quota program, maintaining their database of quota ownership by California producers, monitoring the monthly transactions and calculating the adjustments from the Regional Quota Adjusters. Each month CDFA would inform the California

FMMO Administrator (an employee of USDA) of the funds needed to pay the quota premium *(which would continue to be ~$12 million per month)*. Producers would continue to receive payments for their quota and non-quota milk from their handler, just as now. The only difference is that those handlers would be interacting with the California FMMO Administrator, rather than CDFA. The cooperatives worked closely with both USDA and CDFA in developing this proposal, and have expressed that both agencies believe they can facilitate this type of arrangement.

PROPOSAL TWO: THE DAIRY INSTITUTE OF CALIFORNIA

The proposal put forth by The Dairy Institute, on behalf of their processor members, takes a very different approach. While it does technically include a continued California quota program, it also provides an avenue for producers – both within California and out-of-state – to be paid for their milk without any quota consideration. This alternative price calculation would be a traditional blend price, calculated ***BEFORE*** the quota program is considered.

Under this proposal, the California FMMO Administrator would divide the total pooled revenues by the total pooled milk, and come up with a uniform price *(their proposal also has different producer pay prices based on the location of the "plant of first receipt," but we'll get into that issue in a later article)*. That uniform price is what would be paid to any producer that opts to be part of this alternative calculation. *Only after* those payments are accounted for would CDFA calculate a quota and overbase price from the remaining funds, which would apply only to the California producers who remain under the quota system. The Dairy Institute's proposal also requires that once a producer opts out of the quota system, that decision is irreversible (i.e., your dairy cannot be part of the quota system ever again).

So let's take a look at an example. In March 2015, the California "pool" accounted for $520,623,267.46 in milk sales. That covered about 3.68 billion lbs of milk produced (standardized to 3.5/8.7 composition). As every California dairyman already knows, the Quota price for March was announced at $15.47/cwt. The Overbase price was $1.70/cwt lower at $13.77/cwt. As discussed earlier, those calculations result in approximately $12 million in quota premiums, with the remaining ~$508 million spread out amongst all the producers.

However, if you simply divide the dollars by the milk, you would have actually gotten an average blend price of $14.13 per cwt. So if this were a sample month under the Dairy Institute's proposal, producers would have the option of opting out of the quota system and instead simply receiving the blend price of $14.13 per cwt *(again, there are location differentials in this proposal as well, but we are ignoring those for the sake of simplicity in this article)*.

While this is just an example, it will of course *always* be the case that the simple blend will be higher than the overbase calculation, since the simple blend will not incorporate the roughly $12 million per month needed to pay the quota premiums. If it were an option, California producers with little-to-no quota would be much better off opting out of the quota system and into this traditional blend calculation. In fact, even producers with more substantial amounts of quota could see it in their best interest to sell their quota and instead opt to be part of this uniform blend price calculation. You can see the snowball effect of more and more producers that would opt to sell their quota (to less and less interested buyers) and get paid a blend price instead.

While the Dairy Institute may believe they have found a clever way to divide producers – pitting quota holders against non- or low-quota holders – the reality is that this specific proposal is a "poison pill." The cooperatives have made it clear that they will not support a final California FMMO that doesn't preserve the current quota system. This proposal from the Dairy Institute would fundamentally change the way the quota system operates, and a logical person could easily argue it would be the beginning of the end for that program. So while this proposal may provide discussion at the potential Federal Order hearing, it simply runs contrary to what the cooperatives have made clear is an important priority for their support of a California FMMO.

Keep an eye on future issues of this newsletter for the next in this series of articles on the various California FMMO proposals. There are certainly many issues on our list…