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DATE: February 13, 2015
 TO: Directors & Members

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 FROM: Rob Vandenhoevel, General Manager

MPC FRIDAY MARKET UPDATE

CHICAGO CHEDDAR CHEESE

Blocks - \$.0050 \$1.5300
 Barrels + \$.0025 \$1.4850

Weekly Average, Cheddar Cheese

Blocks - \$.0030 \$1.5320
 Barrels - \$.0060 \$1.4815

CHICAGO AA BUTTER

Weekly Change - \$.0750 \$1.7200
 Weekly Average - \$.0815 \$1.7260

DRY WHEY

Dairy Market News w/e 02/13/15 \$1.4500
 National Plants w/e 02/07/15 \$1.5599

NON-FAT DRY MILK

Week Ending 2/6 & 2/7

Calif. Plants \$1.0397 7,864,339
 Nat'l Plants \$1.0194 19,256,143

Prior Week Ending 1/30 & 1/31

Calif. Plants \$0.9676 19,829,109
 Nat'l Plants \$0.9737 33,817,711

FRED DOUMA'S PRICE PROJECTIONS...

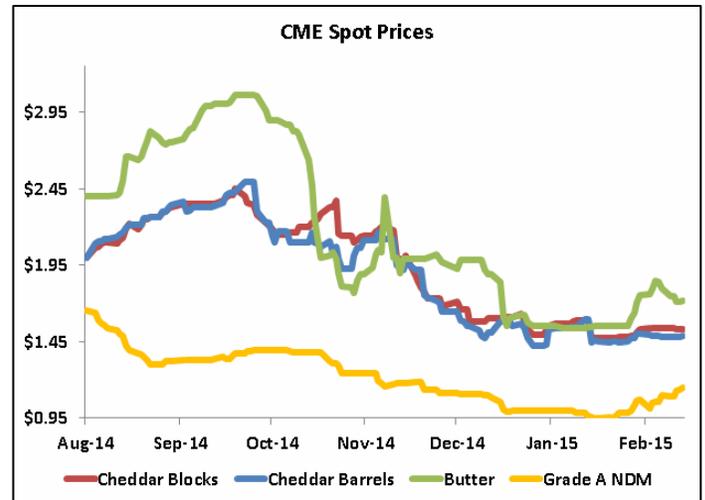
Feb 13 Est: Quota cwt. \$15.70 Overbase cwt. \$14.00 Cls. 4a cwt. \$13.50 Cls. 4b cwt. \$13.74
 Last week: Quota cwt. \$15.76 Overbase cwt. \$14.06 Cls. 4a cwt. \$13.64 Cls. 4b cwt. \$13.77

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

Milk & Dairy Markets

After months on the sidelines, milk powder buyers are back in the game. Over the past two weeks, an astounding 98 loads of Grade A nonfat dry milk (NDM) changed hands at the CME spot market, and spot NDM climbed 8¢ to \$1.15/lb. NDM futures rallied as well.

Spot butter lost a nickel on Monday and another 3.5¢ Wednesday before bouncing Friday amidst a flurry of trades. The market closed at \$1.72, down 7.5¢ on the week. The butter market tends to perk up in late February, as buyers stock up in anticipation of Easter. Caught between the possibility of improved demand and readily available cream supplies, the butter market moved back and forth this week. Class IV futures were similarly mercurial; they collapsed on Monday and spent the rest of the week trying to climb back to the levels of the previous week. They were only partially successful. The February contract lost 44¢ and March through June contracts were 10 to 20¢ lower.



The spot Cheddar markets were quiet in comparison. Blocks slipped 0.5¢ to \$1.53 and barrels added 0.25¢ to \$1.485. Through the first half of the year Class III futures contracts were generally 40 to 60¢ lower than last Friday's settlement. However, deferred contracts moved slightly higher. Most Class III contracts for the second half of the year are holding over \$17/cwt., at prices not seen since November or December.

Although the nearby futures slipped this week, the market feels more buoyant than it did a month ago. What has shaken the dairy complex out of its doldrums? Domestic demand has been robust, but this was also true when prices bottomed in mid-January. In the meantime, the dollar has strengthened and product has piled up at ports on

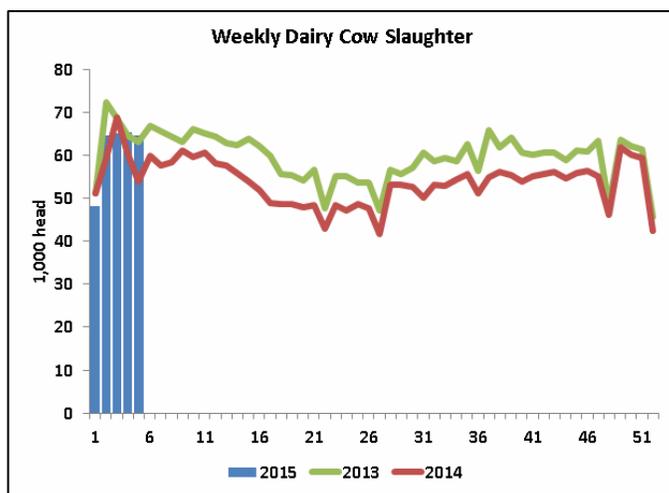
the West Coast. Domestic milk production continues to rise seasonally. The source of the strength must be overseas.

A rising tide lifts all boats, even if those boats and their cargo are left adrift in a labor dispute. Milk powder prices have climbed steadily in Europe and at the Global Dairy Trade auction since the turn of the year, and NDM futures have followed them higher. Milk powder inventories in Europe and Oceania are manageable, and there are legitimate concerns about production in both regions.

The same is not true in the U.S., where milk is flowing and milk powder inventories are growing. With a strong currency and congestion at the ports, U.S. milk powder is reaching global buyers in a trickle rather than a flood. The trade slowdown may be propping up prices overseas. To the extent that strength in those markets has supported U.S. milk powder prices, the port strike may have given the U.S. market a bump, albeit one that is temporary and incongruous. As product continues to languish and warehouses fill up, domestic milk powder prices are likely to ebb.

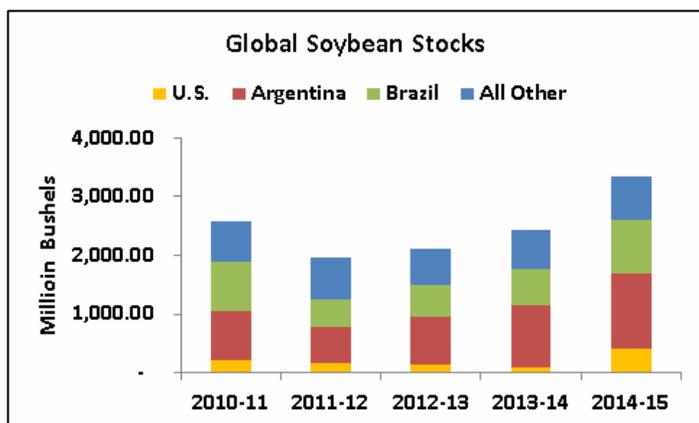
While the longshoreman’s dispute has restricted trade on the West Coast, there are no such issues on the East Coast, and goods are flowing freely between the U.S. and Europe. *Dairy Market News* noted last week that, “The weakness in the Euro, compared to the U.S. dollar, has increased imported cheese sales. Sources in Europe indicate that strong export sales to the U.S. and other countries have considerably reduced inventories with aged cheese supplies unseasonably low.” Even as foreign cheese arrives on our shores, U.S. manufacturers are going strong. Cheese inventories are surely rising.

Dairy producers have clearly stepped up cull rates. For the week ending January 31, dairy cow slaughter totaled 64,728 head, up 20% from the same week a year ago. For the year-to-date, dairy cow slaughter is 4.9% ahead of last year’s pace. In Region 9, which includes California and Arizona, cumulative dairy cow slaughter is 14% higher than in the first five weeks of 2014.



Grain Markets

There were no surprises in Tuesday’s World Agricultural Supply and Demand Estimates. USDA increased its estimate of corn for ethanol demand, but lowered its feed usage estimate, resulting in a 50 million bushel decline in ending stocks. These changes were small relative to the record large crop, and the corn market did little more than yawn in response. March corn futures settled at \$3.8725 per bushel, up 1.5¢ from last week.



The soybean market faded Tuesday as the trade shrugged off USDA’s higher demand estimates and chose instead to focus on the fact that global soybean supplies are abundant. Indeed, end-of-season soybean stocks around the world are expected to rise from 2.4 to 3.3 billion bushels, an increase of 37% from last year.

Harvest is just beginning in South America, and reticent farmers, politics and logistics have made for a slow start to the export season. With U.S. soybean exports surpassing expectations, the soybean market rallied in

the latter half of the week. March soybeans settled at \$9.905, up 17¢ from last Friday. Similarly, March soybean meal closed at \$332.30/ton, up \$2.90 on the week.

Once South American supplies hit the market, U.S. soybean exports could slow dramatically and soybean futures will likely come under pressure. But the market is taking a wait-and-see approach, and for now soy prices are bouncing off of the lows reached earlier this month.

THE CALIFORNIA FEDERAL ORDER PROPOSAL AND QUOTA: *(By Rob Vandenheuvel)* Last week, we all got our first look at the proposal submitted to USDA by California Dairies Inc., Dairy Farmers of America and Land O'Lakes that would establish a Federal Milk Marketing Order (FMMO) in California. While this has triggered a number of questions about a possible California FMMO, one of the most common questions I've heard is, "What happens to California's quota program if we get a FMMO?"

The short answer: **Nothing!**

I could leave it at that (*and for those of you who are content with the short answer, you can stop reading*), but instead will expand on exactly how the current quota system is addressed in the proposed FMMO language.

Before going into that, however, we need to make sure we all understand exactly what California's quota program is (and is not). For starters, it is NOT a limitation on the production of milk. Instead, it is a system that entitles the owners of California quota (which must be a currently operating dairy farmer selling to a pooled milk handler) to a pre-determined payment from the California "pool" in addition to the blend milk price they receive.

Specifically, quota is bought/sold/owned on a "per pound of solids-not-fat (SNF) per day" basis. Depending on where your dairy is located within the State, a single pound of California quota would entitle that dairy to receive between \$0.164 and \$0.195 per day on top of their standard blend price payment that all producers are entitled to. This comes out to a premium of \$1.43 - \$1.70 per hundredweight, assuming an 8.7% SNF composition of raw milk.

The quota program originated when a system of milk "pooling" began in California in the late 1960s. Back then, the calculation of the "quota payment" each month was different, based on several variables (another article for another day). But since the early 1990's, the payment due to quota holders is set by law and does not change from month-to-month.

Since the start of the program in the 1960s, quota that was initially issued, as well as additional quota that was issued in the few year's following has been bought/sold/traded/held by dairymen throughout California. The California Department of Food and Agriculture (CDFA) keeps track of these transactions, and each month reports on exactly how much of the pool revenues were used to pay the quota holders. For instance, in December 2014, the quota holders were cumulatively paid \$11,835,947.41, on top of their equal share of the remaining pool revenues that every pool producer is entitled to (a.k.a. the "Overbase" price).

So while the politics and history of the California quota program are complex, the basic math behind the program is actually quite straightforward and basic. In essence, the first ~\$12 million a month in the California pool goes to the quota holders, and the rest is split out amongst everyone in the pool (including the quota holders). The proposal for a California FMMO put forth by CDI, DFA and LOL continues that monthly calculation of the payments needed from the pool to compensate the quota holders. Each month, CDFA would continue to monitor the purchases/sales/trades of quota, and would make the calculation on how much money is needed to compensate the quota holders. They would then report those calculations to the Federal Order Administrator overseeing the California pool, and those dollars would be paid to the quota holders, through their milk checks from their handler, just as it is done now.

So as you can see, the cooperatives have ensured that their proposal would have zero impact on California's ability to continue operating our quota program. **For those of you who currently own quota: regardless of what you hear at the local coffee shop rumor mill, you can rest assured that nothing in the FMMO proposal would change the way in which your quota is treated.**