Milk Producers Council

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TO: DIRECTORS & MEMBERS **FROM: John Kaczor**

MPC FRIDAY MARKET UPDATE

CHICAGO MERCANTILE EXCHANGE

Blocks	-$.0150	$1.9400
Barrels	+$.0200	$1.9525

Weekly Average

Blocks	+$.0420	$1.9680
Barrels	+$.0330	$1.9485

CHICAGO AA BUTTER

Weekly Change	+$.0225	$1.7475
Weekly Average	+$.0475	$1.7395

NON-FAT DRY MILK
Week Ending 9/19 & 9/20

Calif. Plants	$1.1569	15,628,903
NASS Plants	$1.1597	17,368,932

DRY WHEY

NASS w/e 9/20/08 $.2154 **WEST MSTLY AVG** w/e 9/25/08 $.2000

CHEESE MARKET COMMENTS: The amount of American cheese in cold storage at the end of August, reported by NASS this week, was 4% higher than a year ago, but 1% lower than at the end of July. Total cheese in storage was 6% higher than at the end of last August. Prices did well on the CME this week, although some selling of blocks on Thursday and Friday brought the price down by 1.5 cents per lb for the week. Cheese production is expected to be fairly steady for the next several months and inventories should begin to fall as normal heavy buying for the upcoming sales season begins. The usage of nfdm or condensed skim to fortify cheese vats should be growing substantially. Looking good for cheese prices.

BUTTER MARKET COMMENTS: The amount of butter in storage at the end of August was **15% lower than a year ago,** a drop of almost 40 million lbs, and was 10% lower than it was at the end of July. Prices on the CME this week got as high as $1.765 on Thursday, before losing a bit today. It appears that storage of butter is shifting from manufacturers' warehouses to buyers' locations, partly because of buyer concerns about having enough product on hand when the big seasonal retail demand hits them. Production of butter should also flatten out, and then begin to increase as winter approaches. Just how strong butter exports will be over the September through January period should determine whether butter prices continue their recent strength. CWT's recent export assistance activity should help, but could also lead to price-cutting responses from international competitors. Looking pretty good for butter prices, but they shouldn't really be this high considering what is happening to U.S. consumer confidence at this time.

POWDER MARKET COMMENTS: The bottom seems to be falling away for nonfat dry milk prices. California plant average prices fell by more than 10 cents per lb this week, and are now about equal to the national average price. Sales volumes are fairly strong. DMN reports that buyers are holding back, waiting for prices to fall further. Insiders anticipated this weakness, with an offer last Friday on the CME that pulled the price down by 12 cents per lb, and with another offer this Monday taking another 3 cents away. That price is now at $1.10 per lb. DMN reports that some manufacturers are preparing for the possible need to sell at the U.S. support level of $.80 per lb.

It's a dismal, tragic situation. But you know what will happen? NFDM may be sold at or close to support levels, but **skim milk powder** production will continue to increase and be sold for export at premium prices that are not disclosed to anyone, including all those people who had been demanding greater price transparency. Did anyone really believe that demand? Was it merely nonsense? You want transparency? DMN reported that some nfdm in the Western region sold this week for as little as $1.00 per lb. It's beginning to look like the irrational exuberance that lead to record high prices last year is being followed by irrational fear about competition from New Zealand. You know New Zealand, the country whose dairy exports are controlled almost entirely by Fonterra – and you know Fonterra, the company who partners with Dairy America to handle about 80% of U.S. exports of nonfat dry milk and skim milk powder.

WHEY MARKET COMMENTS: Prices for the entire line of whey-based products continue to move lower. Sales continue at fair levels, but the price weakness in one line appears to feed into weakness in others – and the cycle continues. DMN reports (once again) that prices for dry whey appear to be firming, but the spot market this week in the West lost another cent and is now lower than it's been in five years. Let's see: excellent product, check; prices at bargain basement levels, check; outlook for improvement is dismal, check. Looking for answers, but there doesn't seem to be any.

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FRED DOUMA'S PRICE PROJECTIONS…

Sept 26 Est:	**Quota cwt. $17.87**	**Overbase cwt. $16.17**	**Cls. 4a cwt. $15.47**	**Cls. 4b cwt. $16.63**
Last Week:	**Quota cwt. $18.00**	**Overbase cwt. $16.30**	**Cls. 4a cwt. $15.95**	**Cls. 4b cwt. $16.60**

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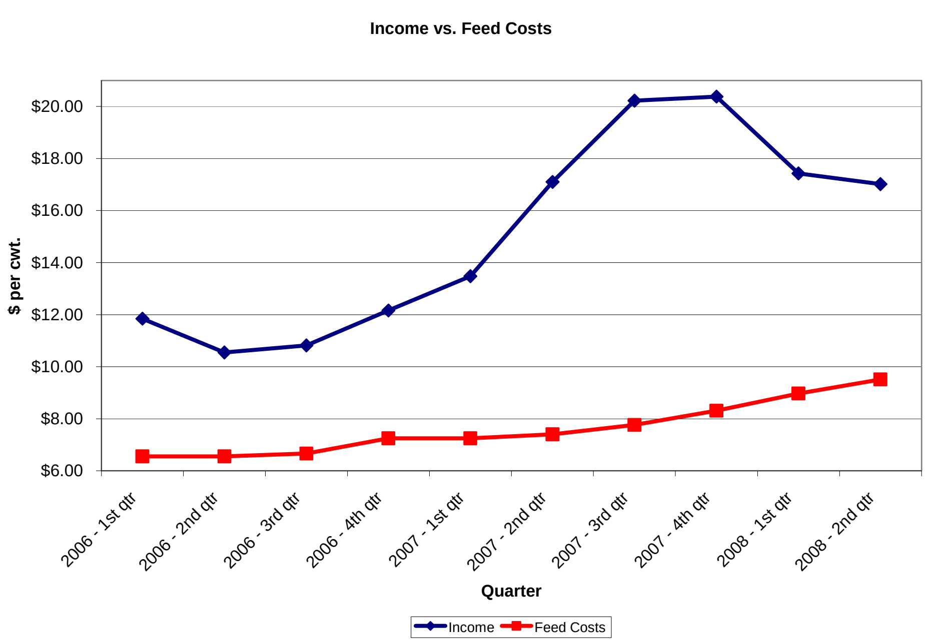
USEFUL COMPARISONS OF GROSS MARGINS FOR DAIRIES ARE HARD TO COME BY: *(By J. Kaczor)* The search for a number of reasonable estimates of **milk income over feed costs** (IOFC), which began several weeks ago, hasn't been very successful. Nothing was found that would be useful or relevant to give California producers a fair comparison of their financial situations to producers anywhere else. So, we are left with the detailed recaps of quarterly income and production costs prepared by our own CDFA Cost Production Unit. Two other estimates that are published monthly, which do not relate to California, are briefly mentioned at the end of this article.

IOFC is the amount of income received from producing and selling milk, less the cost of feeding the cows that produced the milk. It's another term for **gross margin. IOFC can be a basic management tool** if it is set up on either a per cow or a per cwt of milk basis – either way works. To use it, a producer first needs to convert the cost of all the feed on hand and in storage, plus current buys, to a cost per daily ration basis. That figure (expressed as feed cost per cow or per cwt of milk) changes as feed supplies are used up and replaced by fresh supplies, or when changes are made to the ration itself. Those changes, when compared to changes in milk production and income, should help a producer monitor gross margins over time, project future gross margins, and decide what changes may be needed to help control feed costs and protect future income.

Gross margin is the amount of money available to cover all production and management costs after the cows are fed. The graph shown here recaps simple averages of quarterly data prepared by CDFA's cost technicians, on income and feed costs for North Valley, South Valley, and Southern California producers from the first quarter of 2006 through the middle of this year.



The income figures are averages of mailbox prices for the three areas. The feed costs are actual costs reported by producers, and include the cost of feed for dry cows, but not calves and heifers. Because these figures cover three month periods and are published well after the periods end, they don't provide anything useful in the way that real-time monthly IOFC data can provide. These studies do show that

California producers have done an excellent job in controlling general operating costs over that period. About 80% of the total increase in costs per cwt of milk produced over the past two years for the dairies included in the studies came from feed. Total costs (not shown on the graph) increased by $3.79 per cwt; feed costs increased by $2.96 per cwt. The studies also indicate that 2008's 2nd quarter income covered all direct and indirect costs for California producers, but did not fully cover allowances for management and return on investment. These results further suggest that USDA's milk-feed price ratio should be moth-balled.

One way producers in 31 states can **insure gross margins for future months** is the newly launched LGM-Dairy federal insurance program. Only states that already had LGM (Livestock Gross Margin) programs for other animals were included in this program, so California is currently not eligible to participate. (The LGM-Dairy program was briefly reviewed in MPC's April 25th *Update*.) It provides gross margin coverage for milk production up to a maximum of about 1,000 cows, for a single premium which depends upon the amount of milk covered and the level of coverage selected by the insured. Unfortunately, there were no takers for the first month. Learning sessions in various parts of the country are being scheduled to show producers examples of how the program works. The coverage offered by this program is far less costly for a particular level of margin protection than it would cost a producer working with a commodity broker to take necessary positions in the futures and options markets for milk prices and feed commodities.

The two reports of monthly IOFC for dairies mentioned above use state-specific milk prices and simulated feed costs. The first is for Pennsylvania dairies, prepared by Dr. Ken Bailey, Penn State University. It uses a simulated feed cost for a dairy with average production per cow of 65 lbs per day. The second report, covering 21 states, published by Dr. Brian Gould, Wisconsin Center for Dairy Research and Department of Agricultural and Applied Economics, uses a similar approach. Because neither report uses actual feed costs for the areas covered, they really don't provide any useful information for California producers.

DAIRY COUNCIL OF CALIFORNIA: WORKING FOR PRODUCERS AND PROCESSORS: *(By J. Kaczor)* A recent story in the *San Jose Mercury News* about Dairy Council of California's (DCC) mobile classroom program was reprinted Monday on Dairyline.com. It was a reminder of the common interest that California's producers and processors have in promoting good life-long eating habits, which start with every day use of milk and dairy products. **DCC is a great California organization working with school teachers, dieticians, and medical professionals** by providing factual information about the role dairy products play in maintaining healthful life styles. DCC is jointly funded and supported by a very small monthly **investment** by California producers and processors. The *Mercury News* article helped to remind us of that investment, and the good work that comes out of it. Learn about the scope and professionalism of DCC's work by going to www.dairycouncilofca.org. And be sure to contact them if you would like to loan a cow or calf for use in one of their five marvelous mobile classrooms.

MPC SUBMITS ALTERNATIVE PROPOSAL FOR CDFA HEARING ON CLASS 1, 2 & 3 FORMULAS: *(By Rob VandenHeuvel)* This week, MPC proposed that CDFA increase the Class 1 minimum price formula to offset the recently implemented increase in transportation subsidies. These transportation credits and allowances, which already took more than $17.8 million (through August) out of producers' share of the Class 1 revenues, were increased even further on September 1st. CDFA analysis indicates that the new rates being used will **increase the amount taken out of the producer pool by 26 percent**!

MPC's proposal outlined this week would raise the Class 1 minimum price enough to recover this 26 percent increase in subsidy costs. Our message is clear: **dairy families cannot continue to absorb the full costs of these transportation credits and allowances.** CDFA has determined that the transportation subsidies need to be increased (which was implemented as of September 1st), but MPC believe it is the consumers – not the producers – that should cover these increased costs. The dairies already pay the high transportation costs for everything that goes on and off the dairy. Enough is enough. You can read MPC's full proposal at: http://www.milkproducerscouncil.org/092508trans.pdf.

There were two other proposals submitted for consideration at the CDFA hearing scheduled for October 30th and 31st:

- The Alliance of Western Milk Producers, Western United Dairymen and California Dairy Women have proposed a six-month "surcharge" on the Class 1, 2 and 3 formulas, which would temporarily add $1 per cwt. to these three minimum prices. *These three classes represented about 23.5 percent of the overall usage in August, so if we assume that this price increase would have no effect on the amount of California milk that is used in California fluid plants, the total benefit to the producers would be about $0.235 per cwt. for January – June 2009.*
- The Dairy Institute of California *(representing milk processors)* has proposed permanently reducing the Class 1 price by about $1.35 per cwt. and reducing the Class 2 and 3 prices by $0.26 - $0.27 per cwt. *The Dairy Institute justifies their proposal by pointing to competition from neighboring states.*
  You can read these two proposals in their entirety on CDFA's website:
  http://www.cdfa.ca.gov/dairy/dairy_hear_altproposals_Class123.html

If you have any questions about MPC's proposal or the upcoming hearing, please feel free to contact the MPC office at (909) 628-6018.

MPC ASKS USDA TO LOOK FURTHER INTO MANDATORY PRODUCT PRICING STANDARDS: *(By Rob VandenHeuvel)* This week, MPC sent a letter to John Mengel, Chief Economist at USDA's Dairy Program, asking that he look into the Mandatory Price Reporting practices, specifically with regard to exported products like nonfat dry milk and dry whey. As you may recall, John Kaczor has recently been exploring some of the discrepancies between the prices reported to USDA and CDFA for the purposes of establishing the minimum prices paid to dairy farmers, and the substantially higher prices that are received by exporters of these products.

For instance, John Kaczor points out that in the first six months of 2008, the average price for nfdm reported to NASS (for use in Federal Orders) and CDFA (for use in California) was about $1.32-$1.33 per lb. At the same time, exports of nfdm (and a similar product, skim milk powder) were being sold for an average price of $1.677 per lb! Why the large gap? This question hits even closer to home when you consider that for every penny that the California-reported prices moves up or down, the Class 4a price – which accounts for about 35 percent of the California raw milk utilization – moves up and down almost 9 cents per cwt.

While John has raised a number of excellent questions, we are now asking Mr. Mengel to use the information available to USDA to dig deeper into these discrepancies. To read MPC's letter to Mr. Mengel, please visit our website at: http://www.milkproducerscouncil.org/092408mengel.pdf.

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