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: July 11, 2014 **PAGES: 5**
TO: Directors & Members **FROM: Rob Vandenheuvel, General Manager**

MPC FRIDAY MARKET UPDATE

CHICAGO CHEDDAR CHEESE		
Blocks	+$.0025	$1.9700
Barrels	+$.0025	$1.9875
Weekly Average, Cheddar Cheese		
Blocks	- $.0264	$1.9555
Barrels	- $.0261	$1.9645

CHICAGO AA BUTTER		
Weekly Change	- $.0175	$2.3725
Weekly Average	- $.0505	$2.3845
DRY WHEY		
Dairy Market News	w/e 07/11/14	$.6575
National Plants	w/e 07/05/14	$.6942

NON-FAT DRY MILK		
Week Ending 7/4 & 7/5		
Calif. Plants	$1.8161	14,233,424
Nat'l Plants	$1.8585	22,306,200
Prior Week Ending 6/27 & 6/28		
Calif. Plants	*$1.8202*	*11,626,362*
Nat'l Plants	*$1.8798*	*18,945,181*

***

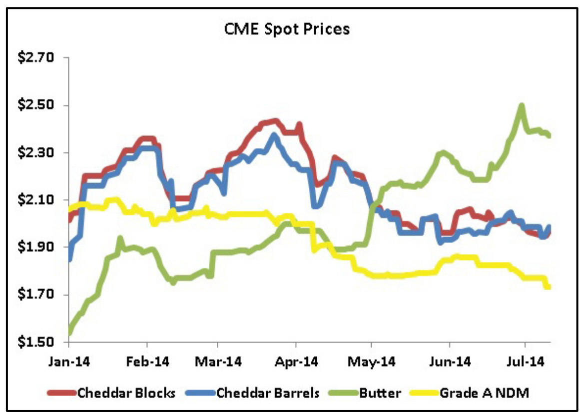
FRED DOUMA'S PRICE PROJECTIONS…

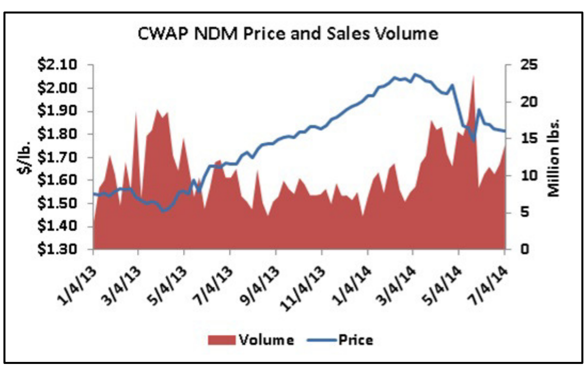
July 11 Est:	**Quota cwt. $22.60**	**Overbase cwt. $20.90**	**Cls. 4a cwt. $23.39**	**Cls. 4b cwt. $18.50**
Last Week:	**Quota cwt. $22.61**	**Overbase cwt. $20.92**	**Cls. 4a cwt. $23.41**	**Cls. 4b cwt. $18.51**

***

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

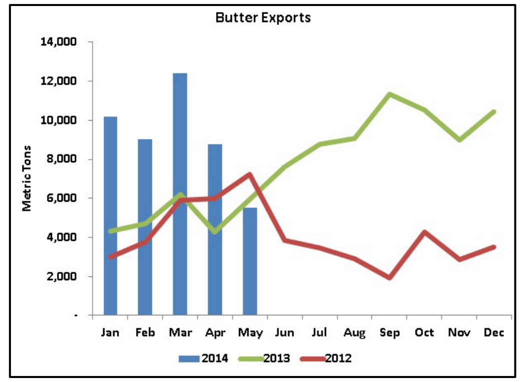
Milk & Dairy Markets
With the exception of the cheese market, the dairy complex took on a more bearish tone this week. Traders who bought futures began to liquidate their positions. Formerly patient producers seem more anxious to add protection. After a couple months of relative stability, CME spot nonfat dry milk (NDM) prices dropped 3.75¢ this week, to $1.7350. The California Weighted Average Price for NDM fell 0.41¢ to $1.8161. Sales volume rose to over 14 million pounds.



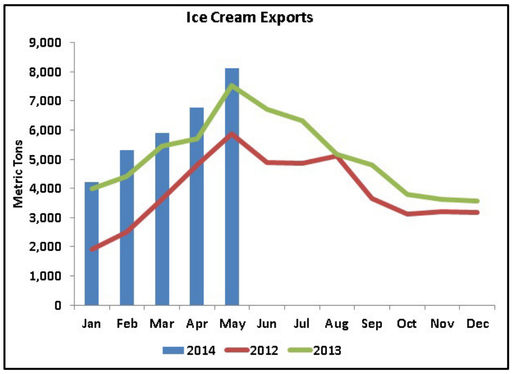


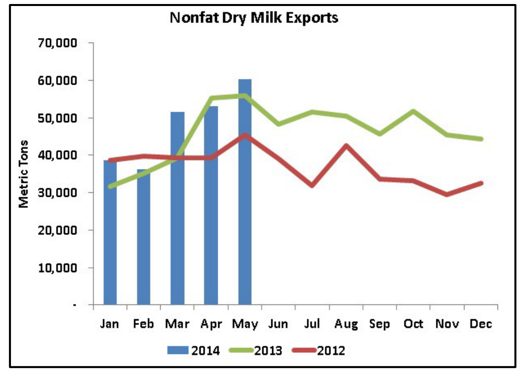
CME spot butter was offered as low as $2.34/lb. on Friday but was bid back up to $2.3725, down 1.75¢ from last week. Spot Cheddar blocks fell to $1.9475 on Wednesday, marking a new low for the year. But buyers stepped in to buy the break, and both blocks and barrels ended this week 0.25¢ higher than last week. A total of 29 blocks and 15 barrels changed hands. Nearby Class III futures managed to gain a few cents, but deferred contracts were 40¢ to 50¢ lower. July Class IV futures were higher but the other contracts were as much as 60¢ lower.

U.S. butter exports faded in May to their lowest total in 13 months. At 5,507 metric tons (MT), butter exports were 39% lower than in April and 8% below May 2013 levels. Ice cream exports reached 8,133 MT in May, besting the previous record set last May by 8.1%. Ice cream shipments were 16.2% greater in May than in April. Demand for ice cream and other products that are heavy in milkfat has tightened the cream market.



Although butter manufacturers would like to churn more and cushion inventories, cream prices are high enough to incentivize butter makers to sell cream rather than churn it. If this trend continues throughout the typical inventory drawdown period in the latter half of the year, it could necessitate an increase in U.S. butter imports later this year. Indeed, if the disparity between U.S. and global butter prices persists, the U.S. could become a net butter importer over the next several months.

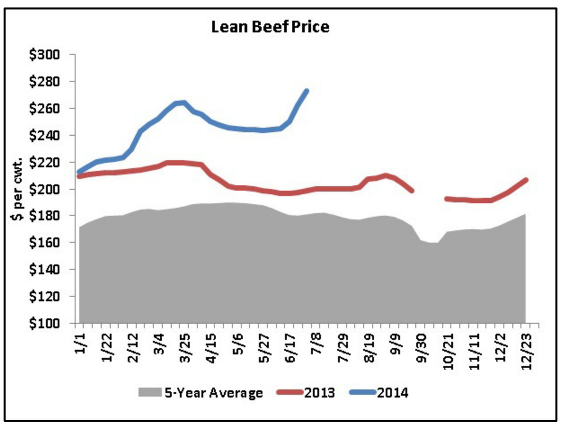


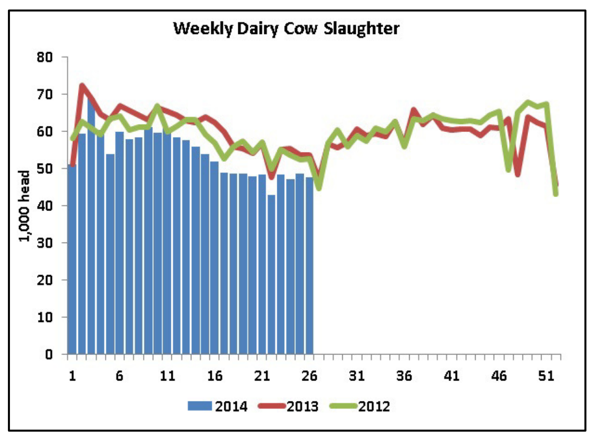


The U.S. exported a record amount of NDM in May, some 60,358 MT or 133 million pounds. This volume was up 8% from May 2013 and 9.9% greater than April exports. The increase was largely due to stepped up sales to Mexico. Mexican importers stood on the sidelines earlier this year, awaiting lower prices. End users in Mexico and elsewhere are likely to continue buying in volume as prices break further.

May cheese exports totaled 31,779 MT, down 8.9% from April but up 15% from May 2013. Demand for pizza-type cheese remains strong, but Cheddar sales are fading.

The cattle market typically falls in June and July as the temperature rises and grilling becomes less of a novelty. But this year, beef prices and cattle futures bucked the trend and ascended in impressive fashion over the past couple months. Lean beef prices are at record highs. However, the cattle market appears to be topping. August futures lost nearly $6/cwt. this week. Beef and cattle supplies will remain tight for the foreseeable future, but it seems the market has finally reached a price high enough to discourage some demand.





For the week ending June 28, dairy producers culled 47,688 cows. This is 11.2% below last year. In the first half of the year, dairy cow slaughter was 10.7% lower than last year.

Grain Markets

Although dairy product markets are succumbing to news of rising global production, dairy profit margins remain excellent. Feed prices are falling much more quickly than milk prices as the weather in the Corn Belt has been nearly ideal. July corn futures lost 17.25¢ this week, and December futures tumbled to nearly four-year lows at $3.8475, down 32.5¢ from last week. July soybean futures fell 92¢ to $12.9575, and November soybeans lost 58.5¢, settling at $10.75.

USDA adjusted its balance sheets to reflect the higher stocks and production figures noted in the June 30 Acreage and Grain Stocks reports. In fact, USDA's new balance sheets call for even larger ending inventories than anticipated, and grain and oilseed markets fell further on Friday. These lower corn prices will foster much lower corn silage prices in the Midwest this fall, and they will likely pressure forage prices nationwide. However, if the drought persists in the West, forage prices in the region will remain stubbornly high.

A SLIGHTLY DIFFERENT ANGLE ON THE "CALIFORNIA DISCOUNT": *(By Rob Vandenheuvel)* Regular readers of this newsletter are very used to seeing a monthly accounting of the significant discount in California's Class 4b price *(for milk sold to California's cheese manufacturers)* compared to the Federal Order Class III price *(the benchmark price for milk sold to cheese manufacturers around the country)*. The latest figures on that discount are included in the table shown here.

The "California Discount" for our State's Cheese Manufacturers		
	June '14	2010 – Jun '2014
California Class 4b Price	$19.07	$15.96
FMMO Class III Price	$21.36	$17.68
Discount	($2.29)	($1.72)

However, this month, I'd like to take the opportunity to also look at this from a slightly different angle, one that really highlights the hypocrisy of the "free market" and "competition" rhetoric we've heard from our State's cheese manufacturers over the past several years. While the impact of this State-sponsored discount has been devastating to producers (through lower overbase prices), the discount has also had an impact on other manufacturing plants, most notably the producer-owned butter/powder manufacturing plants operated by our State's cooperatives.

We've discussed this issue in the past, but since it has been quite a while since then, let's briefly review the basics:

- About 80% of the milk produced in California is sold to Class 4a (butter/nfdm) or 4b (cheese/whey) manufacturing plants. Nearly all of those plants operate as pooled plants.
- The monthly minimum prices announced for each class determines a manufacturer's obligation for the milk they purchase.
- However, the suppliers of milk (i.e., dairy farmers) are ultimately entitled to the overbase price – a blended price that applies to all milk in the state (except for milk covered by California's quota program, which is entitled to a premium).
- The California Department of Food and Agriculture (CDFA) manages California's "pool" which facilitates this difference between a plant's minimum price obligation and the overbase price that their milk suppliers ultimately receive.

It may be helpful to use an example, so let's look at May 2014 – the most recent month that we have final figures on. *(For this example, I'm going to use the simple prices "per hundredweight," but in the actual accounting, it is broken down by fat and solids-not-fat (snf). I will also be ignoring the impacts of the quota program, transportation subsidies and other smaller pool calculations in this example, as it they are separate issues from what we're delving into today.)*

<u>May 2014 – Actual Numbers</u>

<u>Minimum Prices</u>

Class 1, No. CA - $25.88 Class 1, So. CA - $26.15 (fluid)	Class 2, No. CA - $23.55 Class 2, So. CA - $23.79 (yogurt/soft products)	Class 3 - $23.50 (frozen products)
Class 4a - $22.57 (butter/nfdm)	Class 4b - $19.34 (cheese/whey)	

<u>Blended Pool Price</u>

CA Overbase - $21.07

So what do these numbers mean? Well, it depends on who you are. For California dairy families, whether you are shipping your milk to a Class 1, 2, 3, 4a or 4b plant, you're entitled to the overbase price for your milk, which in May was $21.07/cwt.

For manufacturing plants, each plant is treated different based on the products they make (which could be all in once class, or broken up into multiple classes). For instance, let's look at the two largest classes of milk:

- If you were making butter/powder products, and were therefore buying Class 4a milk, these numbers mean that you had to pay $22.57/cwt for your milk; $21.07/cwt of that went to the supplier of your milk as the overbase price, and the difference ($1.50/cwt) was sent to CDFA as a "pool contribution."
- On the other hand, if you were making cheese/whey products, and were therefore buying Class 4b milk, you had to pay the supplier of your milk the same $21.07/cwt overbase price, but only $19.34/cwt came out of your pocket, and the balance ($1.73/cwt) came from CDFA as a "pool withdrawal."

Remember that all the pool contributions sent to CDFA by some manufacturers are ultimately paid back out in pool withdrawals to the other manufacturers (as well as quota premiums and transportation subsidies, but again, those are different issues). So in this example in May 2014, plants that make Class 1, 2, 3 and 4a products all were obligated to contribute money into the pool, and most of that money went to Class 4b plants in the form of a pool withdrawal.

What have these pool contributions and pool withdrawals meant in real dollars? Since the start of 2010, when we started seeing the widening gap between our Class 4b price and the Federal Order Class III price, **California's cheese manufacturers have been on the receiving end of total pool withdrawals in the amount of $610,863,834 through May 2014!** During that same period of time**, Class 4a plants – which are primarily operated by producer-owned cooperatives – have made pool contributions totaling $540,499,060** *(which was where CDFA got most of the money to pay the $610 million to the Class 4b plants).*

Let's think about that for a moment. In hearing testimony and press releases over the past five years, our cheese manufacturers have preached the gospel of "competition" and "free markets." But in reality, because CDFA has seen fit to maintain a significantly discounted Class 4b price, those cheese manufacturers have been on the receiving end of $610 million, which was taken right out of the pockets of the plants they ultimately compete with for a milk supply (Class 4a).

Of course, this is not a new revelation; our pooling system has been in place for more than 40 years, and it is designed this way in an effort to have plants from each class participate in the pool based on their products' ability to generate revenue. What I mean is that the system is built to recognize that if one class of products isn't generating as much value from the milk they buy as another class of products, they shouldn't have the same financial relationship to the pool. And there are certainly been times when the cumulative value generated by cheese/whey products is less than the value generated by other products like butter/nfdm.

However, the scenario we've seen in the past several years is *not* due to market-based differences between butter/nfdm and cheese/whey, but rather a conscious decision by CDFA to artificially discount the Class 4b price. How do we know? Let's take a glance at how our pool numbers would look if **California's Class 4a/4b prices were set equal to the Federal Order Class III/IV prices, which are the benchmark prices for comparable milk sold all over the U.S.?**

A couple of notes before looking at those numbers:

- *For the sake of simplicity, I have not incorporated any changes to the Class 2/3 prices, even though those two formulas are directly tied to the Class 4a prices.*
- *If our State's cheesemakers are to be believed from testimony they've given in the past, they would not have bought as much California milk if our prices were equal to the Federal Order prices. Of course my question to them would be, where would you move to in order to get cheaper milk, as the Federal Order Class III price is the benchmark price driving the value of milk sold to cheese plants all over the country?*

<u>May 2014 – If California's Class 4a/4b prices were set equal to the Federal Order Class III/IV prices</u> ***(adjusted dollar amounts are noted in red)***

<u>Minimum Prices</u>

Class 1, No. CA - $25.88 Class 1, So. CA - $26.15 (fluid)	Class 2, No. CA - $23.55 Class 2, So. CA - $23.79 (yogurt/soft products)	Class 3 - $23.50 (frozen products)
Class 4a - **$22.65** (butter/nfdm)	Class 4b - **$22.57** (cheese/whey)	

<u>Blended Pool Price</u>

CA Overbase - **$22.58**

(You might be wondering why the overbase price is so close to the Class 4a/4b prices, even though the Class 1, 2 and 3 prices are so much higher. That is due to the fact that: (1) Classes 1, 2 and 3 only make up about 20% of the milk; and (2) the pool contributions of the Class 1, 2 and 3 plants in this scenario would have largely been used to pay quota premiums or fund the transportation subsidy program, rather than be paid out as pool withdrawals)

As you can see, while there was a $3.23/cwt difference between the California Class 4a and 4b prices in May *(see graphic on page 3)*, there was a much closer relationship in the Federal Order prices used around the country. In fact, since 2010, while California's Class 4b price has averaged $1.73/cwt below the California Class 4a price, the Federal Order Class III price has only averaged $0.27/cwt below the Federal Order IV price.

In real dollars, had the California Class 4a/4b prices been set at levels equal to the Federal Order Class III/IV prices since 2010, rather than benefit from the significant State-sponsored discount, California's cheese manufacturers would have had an obligation to *pay* about $75 million in pool contributions over those four-plus years (compared to *receiving* $610 million), and our producer-owned butter/powder plants would have seen their pool contributions drop from $540 million to about $185 million.

So while it is true that these monthly prices announced by CDFA are minimum prices that can be bolstered with premiums (not subject to pooling regulations), it is still critical that they be established at an equitable level, as they impact not only the overbase price (as we've painfully watched for several years now), but also the financial obligations of the other manufacturers operating in the State. And in the case of California's manufacturing profile, the biggest financial impact is felt by the producer-owned butter/nfdm plants.

Of course the larger point is to keep these realities in mind as we navigate a path forward. **California's cheese manufacturers have positioned themselves where they are collecting hundreds of millions of dollars from the California pool, all of which originally comes from the pockets of the very plants they compete with for a milk supply, all at a time when the cheese and whey products they produce are valued at historically high prices.** There is very little practical incentive for these cheese manufacturers to change that status quo, and so producers – who are obviously the most financially vulnerable in this situation – need to continue pressing forward with efforts to get a fair and profitable price for our milk over the long-term. **<u>Producers need to take charge of their future; the status quo works just fine for everyone else.</u>**