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MCT DAIRIES, INC.

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Brother, can you spare a load?

The Chicago Mercantile Exchange (CME) Cheddar block and barrel prices are establishing new highs almost daily as end-users search out a market price at which suppliers are willing to "give-up" product. So far that price has not been reached, even as the market surpasses $2.00 per lb.

A glance at the recent production and stock figures indicate that both Cheddar cheese production and American cheese stocks (USDA does not publish a separate Cheddar cheese stock number) are less then last year. Cheddar cheese production in January 2004 was down 1.6%, or 3.9 million lbs., versus the prior year. Meanwhile commercial American cheese stocks totaled 523.5 million lbs. as of February 29, 2004, down 2.8% or 15.0 million lbs.

On the surface these declines suggest market strength, but not necessarily record high prices. Instead, the key underlying market force is "market expectations."

While the current supply may be somewhat tight, the market expects further tightening due to lower milk production. Lower milk production is being driven by a 1.2% decline in the dairy herd and lower milk production per cow because of the rationing of Posilac and higher feed prices. As a result, most end-users are looking for an extra load or two of product, which feeds the price escalation.

Dairy is inelastic

The industry adage is "the cure for high prices is high prices." Demand elasticities are used by economists to predict the percentage change in the quantity demanded due to the percentage change in the price of a particular good. When the price elasticity of a product is less than 1.0, the product is considered inelastic. This means that the percentage change in quantity demanded is less than the percentage change in the product's price.

Several studies of demand elasticities confirm that the wholesale and retail demand elasticities for dairy products are inelastic. According to the Food Agricultural Policy Research Institute (FAPRI) at the University of Missouri, the annual retail price elasticity of cheese is -0.33, butter -0.27 and fluid milk -0.17. This means that a 10% increase in retail cheese prices would be expected to

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KEN'S CORNER

by Ken Meyers
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What a difference a year makes.

Last year the industry was languishing through record low milk and dairy product prices. Today prices have skyrocketed, due to the alignment of several key "events."

The low milk prices in tandem with the closing of the Canadian border led to higher cull cow prices and a retraction in the U.S. dairy herd. Monsanto rationed its growth hormone *Posilac* by 50%. Lower global soybean production propelled soybean prices above $10.00 per bushel, and other feedstuffs have followed suit.

Will we see $2.20 or higher cheese this year? And how long will prices be able to sustain at these levels? These are the questions dominating industry conversations these days.

What next year's price will look like is anyone's guess, but be on the lookout for a convergence of "events" that serve to depress the market back to historical levels. MCT

$20 milk ahead?

The CME block and barrel cheese prices are at all-time highs, while the CME butter price continues well above typical March levels.

Cheese orders are as strong as they've ever been, and plants can't get enough milk to their liking. Meanwhile, in the absence of ready alternatives from overseas, butterfat markets remain short.

April's Class III price will be the highest ever, and by May we could be looking at $20 or above.

MCT Forecast

	Block*	Barrel*	Class III	Butter*	Class IV
MAR	1.8190	1.7970	14.45	2.1250	14.00
APR	2.0750	2.0550	19.35	2.0750	14.10
MAY	2.1050	2.0850	20.20	2.1000	14.20
JUN	2.1250	2.1100	20.50	2.1725	14.40
JUL	2.1550	2.1300	20.80	2.2850	14.80
AUG	2.1800	2.1500	21.20	2.3500	15.35

** Block, barrel and butter are monthly averages of CME prices.*

What makes this year's price hikes so interesting is that they have occurred during the traditional "Spring Flush." As a result, no relief from the record prices appears to be in sight until either milk production increases or demand decreases significantly. MCT

Spare a load ...

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lower cheese demand over time by 3.3%. Likewise, the elasticities for butter and fluid milk indicate that a 10% increase in the retail price would result in a 2.7% decrease in butter demand and a 1.7% decline in fluid milk demand.

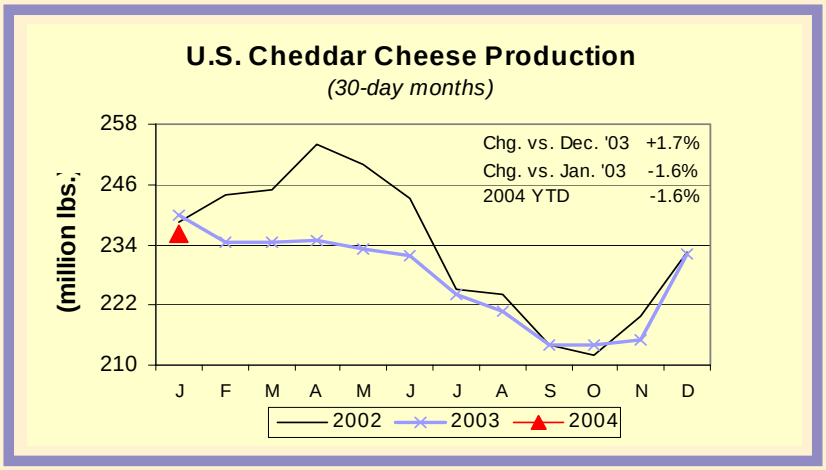
The first major price shock for consumers is expected to come in May as the wholesale fluid milk price (announced April 23) for whole milk increases by nearly 49¢ or almost 45% per gallon versus the prior month. Just how much of this increase consumers realize will depend on the pricing strategies of the retailers. If the full 45% is passed-on then fluid demand over time could be expected to decline by up to 7.6%.

Other dairy product prices are expected to follow the lead of the fluid milk prices and increase significantly by mid-year. The subsequent decrease in demand is likely to be well-timed with the seasonal decrease in milk and dairy product production. Milk production typically falls by 2% in June and by nearly 3.5% in July versus the prior months.

Realignment

At some point, dairy product demand and supply will realign. In 2001 and 1998, when dairy products prices fell from their exceptional highs the declines were precipitous, dropping 20¢ to 30¢ in one week. Such retreats are questionable this time due to lack of replacement heifers, the lingering impact from *Posilac* and the exceptionally high feed prices.

In addition, the Cooperatives Working Together (CWT) program stands ready to implement another herd retirement program and to export cheese and butter when their respective prices fall to $1.30 and $1.20 per lb. If successful at maintaining the market that those prices, that translates into a Class III price floor of about $11.50 per cwt. MCT



In January, Cheddar cheese production was down 1.6% from the prior year.

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