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The Cheese Squeeze

Typically cheese prices do not increase during the Spring flush. But this year is anything but typical. In April, the Chicago Mercantile Exchange (CME) block and barrel Cheddar cheese prices topped-out at \$2.20 per lb. and \$2.17 per lb., respectively.

April's record-high cheese prices along with the lag in the Class III (cheese) milk price prompted cheese manufacturers to add as much nonfat milk solids, either in the form of condensed milk or nonfat dry milk, as they could to bolster

cheese output. In May, the opposite has been true.

Cheese prices have fallen from their April peaks, yet cheese manufacturers face higher milk costs. May's Class III milk price will likely be nearly 85¢ per cwt. higher than April's Class III price. At the same time, cheese manufacturers will sell their May block and barrel cheeses for about 18¢ per lb. and 29¢ per lb. less than in April.

To understand this cheese-milk price squeeze better, let's review the pricing components of the Class III price formula. The Class III

milk price is based off USDA's National Agricultural Statistical Service's (NASS) surveyed prices for block and barrel Cheddar cheese (not more than 30 days of age), butter and dry whey.

However, the NASS cheese prices lag CME cash cheese prices. For example, on May 21, USDA announced the NASS block cheese price of \$2.1638 per lb. for the week ending May 15. The average CME block cheese price for the same week was \$1.96 per lb., more than 30¢ per lb. lower.

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KEN'S CORNER



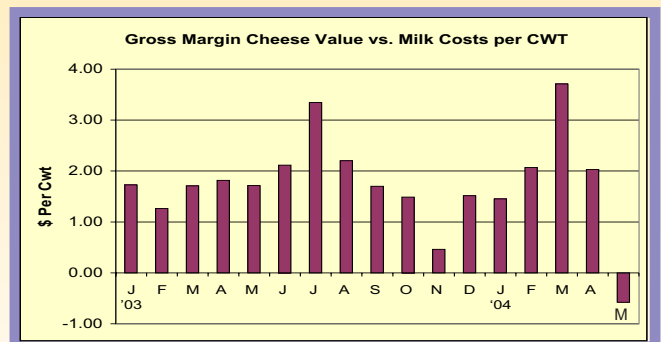
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Negative cheese margins — caused by the lag between the CME and NASS cheese

prices — are not a pleasant financial experience. They are the result of an imperfect pricing system and are a trade-off of

volume for timeliness. USDA's survey captures prices for nearly 20 million lbs. of block and barrel cheese each week. That's a great deal more than any weekly volume of product traded at the CME. Negative margins could be mitigated somewhat if USDA were to

use CME block and barrel prices in the Class III formula. **MCT**



Whipsaw prices ahead?

The butter and cheese markets have softened from their highs, but remain strong historically. With milk production running more than 1.0% lower than a year ago, the future direction of dairy product prices will have more to do with demand changes than a shift in milk supply. We're betting on whipsaw prices during late July and August as the

supply of cheese less than 30 days of age becomes limited and milk is drawn

into the fluid pipeline as schools reopen. **MCT**

MCT Forecast					
	Block*	Barrel*	Class III	Butter*	Class IV
MAY	1.9925	1.8848	20.51	2.0629	14.56
JUN	1.8000	1.7550	17.25	1.8100	13.00
JUL	1.8150	1.7775	17.35	2.0500	14.10
AUG	2.0545	2.0245	18.50	2.1800	14.70
SEP	2.1000	2.0650	20.20	2.2350	14.90
OCT	1.9300	1.8800	19.55	2.0800	14.50

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

The big squeeze...

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On the way up, the lag benefits cheese manufacturers because the selling price of their cheese is rising more rapidly than the cost of milk. During April, cheese manufacturers sold their cheese based off of an average CME block cheese price of \$2.1687 per lb. Using a very simplistic gross margin formula for the cheese price multiplied by 10 (the number of lbs. of cheese converted from a cwt. of milk) yields a gross cheese milk equivalent of \$21.69 cwt. Next, subtract April's Class III price of \$19.66. That leaves a healthy gross margin of \$2.03 per cwt. for the cheese manufacturer.

This gravy train, however, comes to an end when CME cheese prices turn south. The

block cheese price in May is expected to average about \$1.9925 per lb. Multiply that by 10 and the result is a gross milk equivalent of \$19.93 per cwt. Subtract the expected May Class III price of \$20.50 per cwt. and cheese manufacturers are left with a negative 57¢ per cwt. because milk costs exceed cheese revenue.

The timing of this reversal of fortune could not have come at a more inconvenient time. May is typically the strongest milk production month of the year and that pushes manufacturing capacity to its limits. This month's negative cheese margin is causing multi-plant manufacturers to direct more milk into their butter/powder operations. Cheese plants that are accepting surplus milk are doing

so at deeply discounted prices and converting the product into block rather than barrel cheese. Negative cheese margins could continue into June depending on where CME cheese prices settle during the next week.

What is the impact of negative cheese manufacturing margins in May and potentially June? It is fair to say that there will be less cheese (30 days of age or less) for sale at the CME during July than there would have been if cheese margins had been positive.

This opens the door for a possible run-up in the CME block and barrel cheese prices beginning in late July and continuing into August. **MCT**

