



# MCT COMPASS

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## The Skim Squeeze

**H**ow can a commodity go from rags to riches? From January through June 2006, the combined production of skim milk powder and nonfat dry milk (SMP/NFDM) totaled 859.4 million pounds, and was 6.7% greater, or 53.7 million pounds more than, the prior year.

Export sales were sluggish during the first quarter of 2006; sales totaled 131.9 million pounds, down 38.8% compared with the same period in 2005. At that time, milk production was growing at 5% with no slowdown in sight.

From April 2006 through June 2006, the marketplace was so burdened with SMP/NFDM that 64 million pounds was sold to the government at 80 cents per pound. During that same period, the rate of

growth for SMP/NFDM production began to diminish.

SMP/NFDM in June 2006 was 7.0% less than the prior year. That drop followed 16.5% and 19.0% year-over-year production declines in July and August 2006, respectively.

Just as production slowed down, the export market heated up. More than 187.8 million pounds of powder were exported during the second quarter of 2006, a 35-million-pound increase, compared to the same period in 2005. Through July and August, export volumes topped 60 million pounds per month and accounted for nearly 60% of SMP/NFDM output in those months.

The rate of growth in milk production has slowed from the rapid 4% during the first half the year to now less than 2% for the July through September 2006 time period.

The slower growth in milk production in tandem with committed exports of SMP has resulted in less SMP/NFDM available for the domestic market during the period of greatest seasonal demand for a variety of food products, from dairy products to bakery goods.

According to the American Dairy Products Institutes annual survey of domestic nonfat dry milk by end-use in 2005, 63.9% of nonfat dry milk is used by the dairy industry, 16.5% by the confectionery industry, and 6.5% by the bakery industry.

Within the dairy industry, the cheese pull on SMP/NFDM cannot be underestimated. In 2005, more than 61% of the

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## KEN'S CORNER



*by Ken Meyers  
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Next year could be a very interesting and potentially very challenging year for the dairy

industry. On the supply side, increased milk production could be hampered by rising corn prices, reduced rBST usage, and possible impact

an El Nino would have on West Coast milk production.

On the sales side of the equation, export demand for SMP and other dairy products is expected to be even greater in 2007. We see SMP exports growing by an additional 50,000 metric tons more in 2007 due to supply constraints from Oceania and the continued absence of the European Union in global dairy trade. We do not expect export

demand to wait until the second half of 2007 to kick in. Rather, export demand is expected to remain strong into the New Year as suppliers play catch-up on existing contracts and pre-bookings accelerate.

What does that mean for cheese makers in 2007? More competition for milk, higher raw product costs, and less powder available to fortify cheese vats. **MCT**

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## The powder impact

Strong spot SMP/NFDM prices have not translated into higher regulated milk prices. That could change in 2007. If cheese vats continue to demand the milk, nonfat and butter could be left short and the value of those products could exceed the value of milk used to make cheese. High Class IV and low Class III prices could mean very low milk prices in cheese

MCT Forecast					
	Block*	Barrel*	Class III	Butter*	Class IV
Oct	1.2347	1.2430	12.35	1.3206	11.50
Nov	1.2850	1.2750	12.45	1.2950	11.90
Dec	1.2950	1.2750	12.55	1.2800	12.25
Jan	1.2925	1.2672	12.40	1.2550	12.20
Feb	1.2650	1.2390	12.05	1.2500	12.25
Mar	1.2500	1.2250	11.55	1.2850	12.35

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

regions. MILC payments are calculated from the higher of the Class III

or IV price. High Class IV prices could mean no MILC payment. MCT

### Where's the nonfat? ...

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nonfat dry milk used by the dairy industry went into cheese vats. Today, whether in the form of condensed skim or powder, cheese manufacturers continue to enhance their throughput by adding additional solids to their cheese vats, especially during periods of high butterfat tests.

Historically, NFDM manufacturing facilities have served the balancing function for milk supply. In this period of short NFDM supplies, one could question whether there is enough NFDM manufacturing capacity. Clearly, capacity is more than adequate; existing powder plants are currently running at sub-capacity and a new NFDM plant is expected to come on-line in California during the second half of 2007. The NFDM supply constraint is driven by the needs of the cheese sector and its draw on raw milk supplies.

Unlike all users of SMP/NFDM, cheese manufacturers have the

flexibility to use either condensed skim or powder. As a result, the shortage of SMP/NFDM has been intensified by an increased demand for condensed skim.

Unfortunately for dairy producers, the price impact from the shortage in SMP/NFDM is not showing up in milk checks, at least not on a timely basis. Therefore, producers are not receiving the price signal that the market needs more milk.

Take, for example, the California Weighted Average NFDM price for the week ending Oct. 20. The price averaged 87.70 cents per pound, while the midpoint of the *Dairy Market News* Western NFDM price averaged 97.38 cents per pound. That 9.66-cent difference translates into 84 cents per hundredweight to California dairy producers. Likewise, USDA-NASS' NFDM price that is used to calculate Federal Order milk prices has also lagged the spot market, averaging just 91.84 cents per pound for the week ending Oct. 21, 2006.

One of the key factors contributing to the lag in price

movement is the use of these indexes to price product. In other words, the sales of powder are based upon the previous week's NASS price plus an overage. One school of thought is that while the prices are slow to move in an up market, they should be equally slow to move lower in a down market.

When a down market will hit, however, is a matter of debate. Some suggest a "holiday" downturn in November or December, when surplus milk supplies are typically available. Others suggest that the SMP/NFDM market strength is for real and fundamentally a longer-term situation.

Those who support longer-term market strength suggest that cheese plants will continue to demand milk and additional solids through the Super Bowl buy-in in mid-January. The past-year's market run-up was a real wake-up call for skim buyers, and as result, more end-users are expected to take coverage earlier to protect against continued price volatility in 2007. MCT



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