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MCT COMPASS

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Price Enhancement Through Exports

Milk prices are rising and aren't expected to fall any time soon if today's Class III milk futures are any indication of what is to come. The March 2007 through December 2008 Class III milk futures contracts are trading above $14.50/cwt.

Historically a Class III milk price of $14.50 or higher translated into a Chicago Mercantile Exchange (CME) block Cheddar price of $1.60/lb or higher. That is not the case today. CME block and barrel cheese prices have struggled to trade above $1.35/lb this year.

The economic force in the Class III milk price is good old fashioned dry whey. Whey has evolved from land spreading and pig feed to a highly valued food ingredient in food preparations, protein bars, nutritional beverages, and other applications.

Since September 2006, the dry whey price used in the Class III milk price formula has increased from 30 cents per pound to 60 cents per pound. That 30-cent increase has added $1.80/cwt to the Class III milk price. That is real value that historically has only come from the cheese side of the milk value calculation.

Cheese marketers who buy their cheese based off the CME block market are in an enviable position. Dairy producers are basing their production decisions off milk prices of $14.50 to $15.50. The milk is flowing and cheese production and stocks are growing. It is fair to say that if milk prices were $1.80/cwt less, milk production and hence cheese production would also be lower.

Fluid milk buyers are in a less enviable position. The $1.80 increase in the milk price attributed to the whey factor has increased the wholesale milk price by at least 15 cents per gallon. And, based upon today's futures prices, there is still upside of $1.00/cwt in the market. This is likely to result in retail fluid milk prices pushing above $3.50 to $4.00/gallon, a price level that has

Continued on page 2

KEN'S CORNER

by Ken Meyers
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The old paradigm of an $8.00/cwt world market equivalent milk price has been shattered. The combination of changing domestic policies in the European Union and in the United States has resulted in government-held surplus stocks overhanging the market and stifling world market prices in the past.

The new world balance presents a case for more volatility in absence of government stocks and variable weather patterns. This is expected to affect the U.S. domestic market more than ever as a greater percentage of U.S. dairy products are traded in the global arena.

The U.S. dairy industry benefits from a strong domestic demand base for high-valued dairy products. And the industry is well positioned for further growth by capturing the increase in demand for dairy proteins from the worldwide rising middle class. MCT

Flush Arrives Early

USDA reports that January milk production rose just 1.4% vs. the prior year. This was less than expected but could indicate what's to come: modest gains in cow numbers and in milk per cow.

Near term, butter is expected to experience a slight increase reflecting "new crop" butter contract specification that only butter produced after Dec. 1, 2006, can be traded on the CME cash and futures markets effective March 1. And the cheese market is expected to continue to seesaw during the flush, and then rise during summer. MCT

MCT Forecast

	Block*	Barrel*	Butter*	Whey**	NFDM**
Feb	1.3411	1.3378	1.2183	0.6000	1.090
Mar	1.3500	1.3100	1.2675	0.6550	1.150
Apr	1.3500	1.3225	1.3100	0.6900	1.180
May	1.3650	1.3500	1.3300	0.7150	1.200
Jun	1.4175	1.3750	1.3750	0.7400	1.225
Jul	1.4500	1.4500	1.3950	0.7500	1.250

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

The protein boost...

Continued from page 1

resulted in lower fluid milk sales in the past.

Of course, if fluid milk sales slide, more milk will become available to manufacturers who make cheese and whey or butter and nonfat dry milk. Still, there are no worries of burdensome supplies because the domestic and international markets are ready to soak-up any additional product at this time.

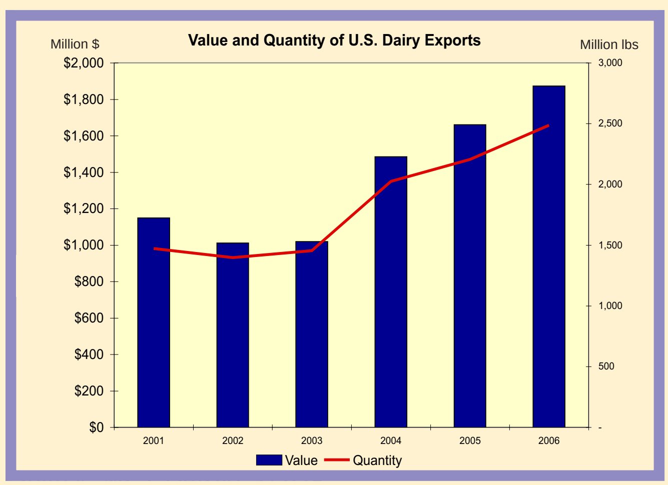
Exports of U.S. dairy products increased 12.8% vs. the prior year and reached a record-high $1.87 billion in 2006, according to USDA's BICO (Bulk Intermediate and Consumer Oriented export data) report derived from the Harmonized Tariff system. The total quantity of dairy products exported reached 2.5 billion pounds. The chart clearly shows that both the volume and value of U.S. dairy exports has grown significantly in this decade.

Domestic production of dry products like nonfat dry milk, whey, lactose, and dairy blends play a major role in the global dairy export markets. In 2006, the United States produced 1.5 billion pounds of nonfat dry milk/skim milk powder, exported more than 631.6 million pounds, and accounted for 31% of the value of all dairy exports.

The market segmentation for dry whey is similar. Production of dry whey totaled 1.0 billion pounds in 2006, with 50% of our production exported. The lactose market is even more export dependent, with 75% of the 698.6 million pounds of U.S. production being sold offshore in 2006.

In total, nonfat dry milk, whey products, and lactose accounted for 56% of the value and 75% of the quantity of U.S. exports in 2006.

Strong export demand for traditional dairy by-products is expected to last through 2007 and into 2008. And that could impact dairy product mix production decisions. MCT



Source: MCT Dairies, USDA.

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