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To Pool or not to Pool

Cheese manufacturers in the Upper Midwest Federal Milk Marketing Order have a tough decision to make. Every August, dairy processing plants, other than fluid processors, must make a decision as to whether to be in, or out, of the Upper Midwest Federal Order for the coming year.

In theory, if all dairy processing plants are regulated by the Federal Order the dairy producers within the order receive a similar milk price. However, the only milk that is required to be regulated is fluid milk (Class I). All other milk has the opportunity, but not the obligation, to be regulated by the Federal Order.

Historically, most cheese plants opted to be “in the pool” or “regulated” due to the financial

incentive. That financial incentive is the “pool draw.” The pool draw is the difference between the “blend price” and the appropriate class price. The blend price is the weighted average value of milk within a Federal Order based upon the prices for Class I (fluid milk); Class II (soft products like yogurt and ice cream); Class III (cheese); and Class IV (butter and nonfat dry milk).

A proxy of the Upper Midwest blend price calculation for April 2007 is shown on the following page. In this case, approximately 20% of the milk within the order is used in Class I, 7% in Class II, 70% in Class III, and 3% in Class IV. Class II, III and IV prices are the same for every order, but Class I prices differ by county. In theory, Class I milk receives the highest price

because it is based off the “higher of” the cheese milk price or the butter/powder milk price plus a Class I differential. Class I differentials are set by county and range from \$1.80/cwt in Chicago to \$4.30 in Miami. In this example, \$1.80 was added to the Class I mover of \$15.00/cwt.

The estimated blend price in this example is \$16.12/cwt. Proprietary dairy plants pooled in the Federal Order are required by law to pay their suppliers, the dairy producers, \$16.12/cwt. In contrast, dairy cooperatives are not required to pay their producers the regulated minimum milk price, but most do, particularly in the Upper Midwest, due to competition for the milk supply.

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KEN'S CORNER



*by Ken Meyers
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Cheese manufacturers are taking a serious look at this year's pooling decision. A year ago, the dry whey price was just 28 cents per pound. Today it is 75

cents per pound. That 47-cent increase has added \$2.82 to the Class III price and is a severe financial burden to cheese plants that do not manufacture dry whey.

If the Class IV price remains above the Class III price, which is expected at a

minimum through the third quarter of 2007, then it probably pays to pool. The multimillion dollar question, however, is whether the pool draw will be closer to a nickel or closer to 50 cents. And that's anyone's guess today. **MCT**

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What goes up....

There appears to be no relief in sight for high dairy product prices. Elasticity's are yet to be tested. Escalating prices have not yet been reflected through the channels, but demand for fluid milk and cheese is about to be tested. The question is not whether demand will fall, but by how much. Then the question

MCT Forecast							
	Block*	Barrel*	Butter*	Whey**	NFDM**	Class III	Class IV
May	1.6894	1.7211	1.4825	0.7575	1.650	17.65	18.35
Jun	1.8500	1.8350	1.5500	0.7550	1.820	20.15	20.25
Jul	1.8825	1.8550	1.5800	0.7525	2.000	20.40	21.90
Aug	1.9025	1.8725	1.6000	0.7400	2.050	20.50	22.45
Sep	1.8575	1.8275	1.6150	0.7250	2.075	19.95	22.75
Oct	1.7600	1.7275	1.6200	0.7000	2.100	18.80	22.95

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

becomes: how efficiently can milk be absorbed into nonfat dry milk for the domestic and export markets? **MCT**

Down on pool draw...

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For the Class II processor to be able to pay its producer \$16.12/cwt, it has to "draw" \$1.61/cwt from the pool (\$16.12 blend price - \$14.51 Class II price) = \$1.61. Meanwhile, the Class I milk processor pays 62 cents per hundredweight into the pool (\$16.80 - \$16.12).

Over the past few months, the difference between the Upper Midwest blend price and the Class III milk price has been about a nickel. The market assessment, an administrative fee assessed by the Federal Order, is 4 cents per hundredweight. The market assessment varies by Federal Order

and has ranged from 4 cents to 8 cents per hundredweight in the Upper Midwest Order in recent years. In other words, in the example below, a Class III processor would draw 3 cents from the pool, but would have to pay a market assessment of 4 cents per hundredweight. That's a loss of a penny per hundredweight just to be in the pool.

Cheese manufacturers in the Upper Midwest are concerned that if they were to abandon the pool, they could be at a competitive disadvantage when procuring milk if

Proxy for Upper Midwest Blend Price			
	Price	Utilization	Blend Impact
Class I	\$21.80	20%	\$4.36
Class II	\$20.70	2%	\$0.41
Class III	\$19.50	77%	\$15.02
Class IV	\$20.00	1%	\$0.20
Est. Blend Price			\$19.99

Source: USDA, compiled by MCT Dairies.

the Class IV price were to exceed the Class III price for an extended period. For the first time since April 2004, the Class IV price was higher than the Class III price and set the Class I mover for June 2007. In the example above, the Class I price is set by the Class IV price. Both the Class II and IV prices are expected to be above the blend price, so the majority of milk in those two classes is expected to be "de-pooled" or not counted within the pool.

As a result, the Class III utilization increases from 70% to 80%. The estimated blend price in this example is \$19.99/cwt. Cheese makers would receive 49 cents per hundredweight to offset their producer payment of \$19.99. Without the 49-cent pool draw, cheese manufacturers in theory cannot afford to pay more than \$19.50 for milk, putting them at a competitive disadvantage. **MCT**

Proxy for Upper Midwest April 2007 Blend Price			
	Price	Utilization	Blend Impact
Class I	\$16.80	20%	\$3.36
Class II	\$14.51	7%	\$1.02
Class III	\$16.09	70%	\$11.26
Class IV	\$16.12	3%	\$0.48
Est. Blend Price			\$16.12

Source: USDA, compiled by MCT Dairies.



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